
AUDIT REPORT



CITY OF WILLIAMSPORT COMMUNITY DEVELOPMENT BLOCK GRANT AND HOME INVESTMENT PARTNERSHIP PROGRAMS WILLIAMSPORT, PENNSYLVANIA

2002-PH-1001

MARCH 19, 2002

OFFICE OF AUDIT, MID-ATLANTIC
PHILADELPHIA, PENNSYLVANIA



Issue Date	March 19, 2002
Audit Case Number	2002-PH-1001

TO: Joyce Gaskins, Director, Office of Community Planning and Development, Mid-Atlantic, 3AD

Daniel G. Temme

FROM: Daniel G. Temme, District Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: City of Williamsport
Community Development Block Grant and
HOME Investment Partnership Programs
Williamsport, Pennsylvania

We completed an audit of the City of Williamsport's Community Development Block Grant (CDBG) and Home Investment Partnership (HOME) Program operations. The audit was completed at your request based on the number of deficiencies your staff identified in the City's program administration during a routine monitoring review that your office completed in June 2000. The primary objectives of our audit were to determine whether the City was administering its Programs in an economical and efficient manner and in accordance with the terms of its grant agreements with HUD and applicable Federal laws and HUD regulations.

Based on our review, we found the City was not efficiently or effectively administering its CDBG and HOME Programs in accordance with the terms of its grant agreements with HUD and applicable Federal laws and HUD regulations. Specifically, for the six activities reviewed, we found the City violated 22 specific program regulations of which several had multiple violations. The report contains one finding and numerous recommendations to improve the effectiveness of the City's operations.

Within 60 days, please give us, for each recommendation made in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact George A. Datto at (215) 656-3401, Ext. 3491.

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Executive Summary

We completed an audit of the City of Williamsport's Community Development Block Grant (CDBG) and Home Investment Partnership (HOME) Program operations. HUD's Pennsylvania State Office of Community Planning and Development (CPD) requested the Office of Inspector General (OIG) perform an audit of the City's Programs after it identified numerous deficiencies in the City's administration of the Programs during a routine monitoring review in June 2000. The primary objectives of our audit were to determine whether the City was administering its CDBG and HOME Programs in an economical and efficient manner and in accordance with the terms of its grant agreements with HUD and applicable Federal laws and HUD regulations.

We found the City was not efficiently or effectively administering its CDBG and HOME Programs in accordance with the terms of its grant agreements with HUD and applicable Federal laws and HUD regulations. For the six activities reviewed, we found the City violated 22 specific program regulations of which several had multiple violations. Also, the City violated many of the provisions of the Office of Management and Budget Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments. This occurred because the City did not have a sound internal control environment (management controls) in which to execute the programs in accordance with the regulations. As a result, the City funded ineligible activities totaling \$2,062,180, made unsupported payments and drawdowns totaling \$576,190, and ultimately executed activities that may not have fully benefited the low and moderate-income persons whom Congress intended to benefit. The management control deficiencies we identified, effects on the programs and our recommendations are summarized below and detailed in the finding and appendix sections of this report.

Management Control Deficiencies

We found the City did not have a sound internal control environment in which to execute the CDBG and HOME Programs in accordance with the terms of its grant agreements with HUD and applicable Federal laws and HUD regulations. Specifically, we found the City:

- Community Development staff lacked the direct knowledge and experience in HUD programs and regulations needed to effectively and efficiently administer its CDBG and HOME Programs according to Federal laws and HUD regulations. Further, the City did not provide staff adequate program training; and, supervision of the programs was not sufficient to ensure the programs were properly administered;
- had not developed and implemented all of the policies, procedures, and management tools it needed to ensure it administered its programs in compliance with applicable Federal laws and HUD regulations. Specifically, the City needed written policies and

procedures for processing purchase requests, traveling on official business and time reporting. Other existing policies, procedures and management tools (procurement, payment, and rehabilitation procedures, organizational charts, position descriptions) needed to be updated;

- lacked an adequate Financial Management System. The City failed to: detect and correct an accounting error in a timely manner; issue required Internal Revenue Service forms; adequately control assets purchased with grant funds; and support a drawdown of HOME funds;
- did not have an adequate record management system. In general, the City's files (rehabilitation, business loan, personnel) were incomplete and disorganized. The poor condition of the City's files and the time it took the City to locate key documents unnecessarily delayed our audit; and
- did not fully implement Federal procurement regulations as was defined in its own procurement policy; and did not adequately monitor its CDBG and HOME funded activities.

Effects on CDBG and HOME Programs

The City's failure to develop and implement a sound internal control environment to administer its CDBG and HOME Programs resulted in the following:

- five of the six activities we reviewed did not meet program eligibility requirements and should not have been funded;
- two of the six activities we reviewed did not meet a National CDBG Objective in benefiting low and moderate-income persons as Congress intended;
- \$2,060,594 of ineligible expenditures, \$411,190 of unsupported expenditures, an unsupported \$165,000 drawdown of HOME funds, and \$1,586 of ineligible expenditures for business lunches were identified;

- the City did not fully disclose details about funded activities in its annual plans and did not report, or accurately report, accomplishments for its activities in performance reports to HUD;
- assistance was provided to ineligible homebuyers; and
- dwellings were rehabilitated without correcting all code and safety violations.

HUD Management Actions Taken

CPD questioned the City's ability to administer its Programs in monitoring reviews it completed in 1992 and in June 2000. Based on these continued concerns, CPD decided to more closely monitor the City and required the City to obtain prior approval for most of its expenditures. Due to the continued problems it experienced in getting the City to resolve all monitoring deficiencies, in August 2001, CPD changed the City's funding process from drawing down funds as needed, to a method where funds were to be reimbursed only after they were already paid from local funds. However, in September 2001, the Assistant Secretary for Community Planning and Development revised the local CPD action because he believed the action carried with it the unintended consequence of stopping the City from executing its programs. The Assistant Secretary re-affirmed the requirement the City must submit sufficient documentation to support their drawdown of funds in a satisfactory manner and voluntarily resolve the outstanding compliance problems, or run the risk that current funding could be terminated, reduced or limited, or future grants could be reduced, withdrawn or adjusted.

City of Williamsport Actions Taken

By resolution 6583, dated June 7, 2001, the City of Williamsport appointed a Special Counsel experienced in the operations of these programs to provide legal services in connection with CPD's monitoring review and this audit. Among other items, the contract called for the review of existing documentation and correspondence, assessing alternative approaches to project eligibility, providing training to staff, and preparing documentation for negotiations and/or hearings with HUD. During our audit and at the Exit Conference, held on January 16, 2002, the City advised us of some of the actions taken and to be undertaken. These actions include developing alternative approaches to project eligibility for the projects we found to

be ineligible and obtaining additional documentation to support expenditures that was not available at the time of our fieldwork. The City asserted that the additional documentation and the different interpretations of the regulations would reduce the amount of the questioned and disallowed costs.

Recommendations

We made a number of recommendations designed to improve the City's administration of its CDBG and HOME Programs and for CPD to monitor the City's progress in implementing those recommendations. Key recommendations require the City to (1) continue submitting supporting documentation for funded activities until it demonstrates the capacity to administer its programs without supervision; (2) establish a formal training program with minimum annual training requirements and train staff; (3) develop and implement new written administrative policies and procedures or revise existing policies and procedures that are outdated; (4) create an inventory control system in compliance with HUD regulations; (5) review and revise employee position descriptions, and establish performance standards for an annual evaluation of Office of Economic and Community Development (OECD's) staff; (6) establish an adequate file system; and (7) reimburse HUD for all ineligible costs, unsupported costs and drawdowns which it cannot adequately support. We also recommend CPD request an opinion from the Department of Labor on whether Davis-Bacon Act provisions apply to the HOME funded Homebuyers Assistance activity.

Findings and Recommendations Discussed

We discussed the results of our audit with the City and HUD officials during the course of the audit and provided the City a discussion draft report on December 7, 2001. We held an Exit Conference with the City on January 16, 2002. The City provided written comments to our finding on February 11, 2002. We included pertinent comments in the finding. The grantee's full response is included in Appendix H. We considered the comments in preparing our final report.

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Abbreviations

CDBG	Community Development Block Grant
CFR	Code of Federal Regulations
CPD	Community Planning and Development
HOME	Home Investment Partnership Program
HUD	US Department of Housing and Urban Development
OECD	Office of Economic and Community Development, City of Williamsport
OIG	Office of Inspector General
OMB	Office of Management and Budget
OOSF	Owner Occupied Single-Family Housing

Introduction

Background

The City of Williamsport, Pennsylvania qualifies as an entitlement community to receive funds under HUD's CDBG and HOME Programs. From 1994 to 2000, the City's allocations under the CDBG Program totaled \$11,763,000 and under the HOME Program totaled \$2,834,000. The following table displays the allocation by fiscal year.

Fiscal Year	CDBG Grant	HOME Grant
1994	\$ 1,668,000	\$ 500,000
1995	1,753,000	340,000
1996	1,709,000	376,000
1997	1,678,000	368,000
1998	1,644,000	396,000
1999	1,655,000	428,000
2000	1,656,000	426,000
Total	\$ 11,763,000	\$ 2,834,000

The CDBG Program provides eligible metropolitan cities and urban counties with annual direct grants they can use to revitalize neighborhoods, expand affordable housing and economic opportunities, and/or improve community facilities and services, principally to benefit low and moderate-income persons. CDBG funds are commonly used for the acquisition of real property, site clearance, housing rehabilitation, code enforcement, relocation of displaced persons, and economic development loans and grants. The CDBG Program is authorized under Title I of the Housing and Community Development Act of 1974, Public Law 93-383, as amended. The program regulations are contained in Title 24 CFR Part 570 (Title 24 CFR hereafter referred to as 24 CFR).

For 1998 and 1999, the City of Williamsport planned to use CDBG funds for street improvements, public facilities improvements, rehabilitation of single-unit residential households, crime awareness, site clearance and demolition, housing code enforcement, and program administration costs.

Title II of the Cranston-Gonzalez National Affordable Housing Act of 1990 created the HOME Program. Program regulations are contained in 24 CFR Part 92. In general, the purpose of the HOME Program is to expand the supply of decent, safe, and affordable housing for very low-income and low-income persons, and to strengthen public-private partnerships in the production and operation of such housing. As a housing block grant, the HOME Program gives participating jurisdictions discretion over which activities to pursue. These activities may include acquisition, rehabilitation, new construction, and tenant-based rental assistance. In addition, participating jurisdictions may provide assistance in other forms such as loans, advances, equity investments, and interest subsidies.

For 1998 and 1999, the City of Williamsport planned to use HOME funds for direct homeownership assistance, homeownership assistance through Community Housing Development Organizations, rehabilitation of single-unit residential households, and program administration costs.

Representatives from HUD's Pennsylvania State Office of CPD performed a monitoring review of the City's CDBG Program in December 1992 and questioned the City's capacity to administer its program. CPD performed a review of the City's rehabilitation programs in June 1994 and recommended corrective action to address four program deficiencies. In June 2000, CPD performed a monitoring review of the City's CDBG and HOME Programs and identified 13 findings regarding noncompliance with HUD regulations including maintaining source documentation, monitoring subrecipients and determining the reasonableness, allowability, and allocability of costs. The CPD Director requested the OIG conduct a review of the City's CDBG and HOME Programs.

The City of Williamsport Office of Economic and Community Development (OECD) is responsible for administering the City's Community Development activities. The Director of OECD is Mr. Donald V. Riles. The OECD offices are located in Williamsport City Hall, 245 West Fourth Street, Williamsport, Pennsylvania.

During the period covered by the audit, three Mayors were responsible for the administration of the City's Community Development activities. The current Mayor assumed the responsibility on November 29, 2000.

Audit Objectives

Our audit objectives were to determine whether the City of Williamsport carried out its activities in an economical and efficient manner; complied with its grant agreements with HUD and with statutory and regulatory requirements, laws and regulations; and expended program funds on costs that were eligible, properly supported, and met national program objectives.

Audit Scope and Methodology

To accomplish our audit objectives we performed the following:

- Reviewed the terms of the City's grant agreements with HUD and applicable Federal laws and HUD regulations to gain an understanding of the CDBG and HOME Program requirements;
- Non-statistically selected eight activities from the City's 1998 and 1999 annual plans, and tested the activities for compliance with CDBG and HOME Program requirements. We selected seven high

dollar value activities from the 1998 plan and one low dollar value activity from the 1999 plan. We performed a limited review on two of the eight activities because we detected no significant problems. We did a full review on the remaining six activities. The total value of the eight projects was \$3,480,722 and the total funds provided to the City for 1998 and 1999 was \$4,123,000;

- Interviewed appropriate staff from the City, CPD, and outside parties involved with the six audited activities including a local developer, a property manager, investors and former employees of a failed business venture and a local bank official;
- Examined files, financial documents, records, plans, monitoring reviews, and other reports maintained by the City and CPD;
- Interviewed six homeowners assisted with HOME funds under the City's Homebuyer Assistance activity and inspected five Owner Occupied Single-Family Housing (OOSF) rehabilitation projects; and
- Reviewed the City's system of internal control (management controls). During the survey phase of the audit we noted major weaknesses in the City's internal control system relating to the administration of the Community Development programs. We, therefore, used OMB Circular A-133, Appendix B, Part 6 as a guide to determine the major areas of weakness in the City's system, as it related to the Community Development programs.

We conducted the audit from August 2000 to August 2001. The audit covered the City's operations from October 1997 to December 2000. We expanded the scope of our review to prior or subsequent periods as necessary. We performed our audit in accordance with generally accepted government auditing standards.

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Community Development Programs In Substantial Noncompliance With HUD Regulations

The City did not efficiently or effectively administer its CDBG and HOME Programs in accordance with the terms of its grant agreements and HUD regulations. This occurred because the City did not have an adequate internal control system (management control system). The City: had staff that lacked direct knowledge of Federal laws and HUD regulations, formal training and supervision; did not develop, update or implement policies, procedures, or control systems; and lacked an adequate financial management system and an adequate record keeping system. Also, the City did not: follow procurement requirements; monitor its activities; and fully or accurately disclose details about its activities in its annual plan sent to HUD. As a result: five activities did not meet program eligibility requirements and should not have been funded; two activities did not meet a national objective; ineligible payments were made totaling \$2,062,180; and unsupported payments of \$411,190, and unsupported drawdowns of \$165,000 were made. Ultimately, the programs may not be fully benefiting the low and moderate-income persons whom Congress intended.

Criteria

24 CFR Part 570 and Part 92 contain the requirements for the CDBG and HOME Programs, respectively. Office of Management and Budget (OMB) Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, establishes the standards for determining costs for Federal awards.

OMB Circular A-102 Common Rule was codified by each Federal agency as the Grant Management Common Rule. The Common Rule establishes consistency and uniformity among Federal agencies in the management of grants and cooperative agreements with State, local, and federally-recognized Indian tribal governments (non-Federal entities). This Circular requires non-Federal entities receiving Federal awards establish and maintain a system of internal control designed to reasonably ensure compliance with Federal laws, regulations and program compliance requirements. The Single Audit Act of 1984 establishes requirements for non-Federal entities that administer Federal financial assistance programs. The Single Audit Act of 1996 extends OMB Circular A-133's, Audits of State, Local Governments, and Non-Profit Organizations,

coverage to those non-Federal entities and establishes a Compliance Supplement (Appendix B of Circular A-133) which provides an invaluable tool to non-Federal entities and auditors. Contained in the Compliance Supplement as Part 6 is a section on internal controls. Part 6 is intended to assist non-Federal entities and their auditors in complying with internal control requirements by presenting characteristics of internal control, which may be used to reasonably ensure compliance with compliance requirements.

Programs Not Administered In Accordance with Federal Law and HUD Regulations

A. The City did not administer its programs in accordance with Federal law and HUD regulations.

For the six CDBG and HOME activities we reviewed, we found the City violated 22 specific HUD program regulations of which several had multiple occurrences. Also, the City violated many provisions of OMB Circular A-87, and did not establish an adequate internal control system required by OMB Circulars A-102 and A-133. HUD regulations at 24 CFR Part 570 and 24 CFR Part 92 represent important parts of the City's agreements with HUD for CDBG and HOME funds. The following table displays the major deficiencies and the unsupported and ineligible cost, by activity, identified during our audit.

Activity - ➡	Community Policing	Public Facility	OOSF Rehabilitation	Business Loan Guarantee	Homebuyer Assistance	Blight Elimination
Program - ➡	CDBG	CDBG	CDBG/HOME	CDBG	HOME	CDBG
Appendix - ➡	A	B	C	D	E	F
Deficiencies ↓						
Eligibility	X	X	-	X	X	X
National Objectives	-	X	-	-	-	X
Supporting Documentation	X	X	X	X	X	-
Activity Assessment	-	-	-	X	X	-
Monitoring Activities	-	X	-	-	X	-
Violations of OMB Circulars	X	X	X	X	X	X
Disclosure in plans/reports	X	-	X	-	X	X
Unsupported Cost	\$394,735	\$-0-	\$16,455	\$-0-	\$-0-	\$-0-
Ineligible Cost	\$21,071	\$20,000	\$-0-	\$480,000	\$1,189,523	\$350,000

X = Activity contains deficiencies

OOSF = Owner Occupied Single-Family

The City's failure to administer its CDBG and HOME Programs in accordance with the terms of its grant agreements with HUD and applicable Federal laws and HUD regulations, resulted in total ineligible and unsupported expenditures of \$2,471,784 as reported in the above table and discussed in the various appendices attached to this report. In addition, the city improperly charged the program \$1,586 for the Mayor's business lunches and made an unsupported drawdown of \$165,000. Those two items are not included in the above table since they could not be identified to the activities included in the table.

The following is a detailed summary, by program, of all the laws and regulations the City violated. Detail results of our review for each activity can be found in Appendices A through F of this report.

Violations of CDBG and HOME Regulations

1. The following are violations of the laws and regulations that apply to the CDBG and HOME Programs:
 - a. **Noncompliance with Eligibility Requirements:**
The City did not comply with eligibility requirements for five of the six activities we reviewed. The following is a summary of those noncompliances.
 - (1) **Community Policing:** Contrary to 24 CFR 570.201(e) the City did not demonstrate the policing activity constituted a new service or an increase in the level of existing services. (See Appendix A for details.)
 - (2) **Public Facility (Skateboard Park):** Contrary to 24 CFR 570.201(c) the facility was constructed on private property, not City (public) property as required. (See Appendix B for details.)
 - (3) **Business Loan Guarantee:** Contrary to 24 CFR 570.209(a) the City did not conduct proper underwriting procedures before committing to fully guaranteeing a bank loan. (See Appendix D for details.)

- (4) **Homebuyer Assistance:** Contrary to 24 CFR 92.250(b) the City did not perform the required assessment to ensure the investment of HOME funds was not more than what was needed to provide affordable housing. (See Appendix E for details.)
 - (5) **Blight Elimination:** Contrary to 24 CFR 570.203(b) the City provided funds to a for-profit entity for residential construction. A for-profit entity could only receive these type funds to carry out an economic development project, which this activity is not. (See Appendix F for details.)
- b. **Lack of Supporting Documentation:** 24 CFR 570.506 and 24 CFR 92.508 requires each grantee to establish and maintain sufficient records to document whether the grantee has met program requirements. We found the City did not maintain documentation to demonstrate compliance with requirements for the activities we reviewed. (See Appendices A, B, C, D and E for details.)
- c. **Lack of Action Prior to Committing Funds:** 24 CFR requires the City to perform basic underwriting procedures prior to guaranteeing a bank loan and to perform a total assessment of the activity prior to obligating funds for that activity. The City did not perform those required actions.
 - (1) **Required underwriting was not performed:** 24 CFR 570.209(a) requires grantees to conduct basic financial underwriting for economic development activities. We found the City did not perform the required underwriting before committing to guarantee a bank loan for a start-up company. (See Appendix D for details.)

(2) **Assessing the amount of funds needed:**

The City did not perform an assessment to determine that no more than the amount of HOME funds necessary were obligated to provide affordable housing, as required by 24 CFR 92.250 (b) and CPD Notice 94-24 (IV): Layering Guidance. (See Appendix E for details.)

- d. **OMB A-87 Not Followed:** OMB Circular A-87 provides principles for determining allowable costs for Federal awards. This Circular stipulates governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices. Under the Circular, costs must be necessary and reasonable for proper and efficient performance and administration of Federal awards. Further, the Circular provides information on determining the reasonableness of a given cost.

We found the City did not efficiently and effectively administer its CDBG and HOME Programs in compliance with underlying agreements and program objectives and resulted in some expenditures that were unreasonable and unnecessary. (See Appendices A thru F for details.)

- e. **Procurement Regulations Not Followed:** 24 CFR 85.36 sets forth the procurement requirements that must be followed with Federal funds. The City did not adhere to the procurement regulations when making purchases with Federal program funds. (See Part F.1. of this finding for details.)
- f. **Property Management System (Inventory System) Not Established:** 24 CFR 85.32(d) requires grantees to develop and implement procedures for managing equipment purchased with grant funds. The City did not maintain an inventory list that met those requirements, as the one maintained by the City was incomplete and

out of date. (See Part D.3. of this finding for details.)

- g. **Lack of Monitoring:** 24 CFR 85.40 requires grantees to be responsible for monitoring their supported activities to ensure funds are used in accordance with all applicable regulations. We found the City did not adequately monitor the activities it funded with CDBG and HOME funds. As a result, the City did not have the means or mechanism for verifying that funds were used in accordance with the regulations and for the purposes intended. (See Part G of this finding for details.)
- h. **Lack of Disclosure in Plans and Reports:** The City did not fully disclose details about its CDBG and HOME funded activities in its annual plans, as required by 24 CFR 91.220 or its performance reports, as required by 24 CFR 91.520. Also, the City did not amend the approved plan as required by 24 CFR 91.505. (See Part H of this finding for details.)
- i. **Lack of An Adequate Financial Management System:** 24 CFR 85.20(b) requires grantees to meet standards for financial reporting, control and accountability for personal property and assets, and maintaining source documentation for accounting records. The City's system was inadequate. (See Part D of this finding for details.)

Violations of CDBG Regulations

- 2. The following are violations of the laws and regulations that apply to the CDBG Program:
 - a. **Noncompliance with National Program Objectives:** The following is a summary of noncompliances with national program objectives:
 - (1) **Blight Elimination:** 24 CFR 570.200(a)(2) states that funded activities must meet at least one of the program's national objectives. 24 CFR 570.208 (d)(1) and 24

CFR 570.505 (a) require a subsequent use of property acquired and cleared with CDBG funds be used to meet a national program objective. We found the blight elimination activity did not meet these requirements since the City loaned CDBG funds to a developer to acquire and clear an abandoned, blighted factory complex, and to construct market-rate housing on the cleared property, which did not benefit low and moderate-income persons. (See Appendix F for details.)

- (2) **Public Facility:** 24 CFR 570.208(a)(1) states, for an area benefit activity to meet national objective criteria, the benefits of the activity must be available to all the residents in a particular area, where at least 51 percent of the residents are low and moderate-income persons. The skateboard park activity did not meet this objective. (See Appendix B for details.)

b. Loan Payments to Creditors Not Reviewed:

24 CFR 85.20 (b)(3) requires controls and accountability must be maintained to assure cash is used solely for authorized purposes. There was no indication the City reviewed the payments to the creditors, for the Business Loan Guarantee activity, to determine if the costs were legitimately attributable to the company's business. Also, contrary to OMB Circular A-87, there was no evidence that any determination was made that payments were prudent, considering the company's circumstances. (See Appendix D for details.)

c. Unreasonable and/or Unnecessary Expenditures:

CPD, during its 2000 monitoring review, identified 20 unreasonable and/or unnecessary expenditures of CDBG funds totaling \$85,987. Those expenditures were for: the Mayor's business lunches; indirect costs; rent paid to the redevelopment authority; audit fees; registrations; memberships; dues; etc. In its

monitoring report, CPD tasked the City to justify the expenditures or reimburse the program. Also, the City was to review all other expenditures from 1998 to the present, not covered by CPD's review, summarize and report the results, and repay any unreasonable, unallowable, and unallocable costs.

In September 2000, the City provided support for \$5,685 of the \$85,987 for training costs, registrations, and audit fees; and in October 2000 repaid \$7,996 to the program for registrations, Mayor's luncheons, business and leadership luncheons, and membership dues, but did not make a review to determine if additional unreasonable, unallowable, and unallocable costs were charged to the program. Since we did not see any evidence that the City performed the review, as a test, we reviewed the City's 1998 General Program Administration activity file to determine if additional expenditures were made for luncheons.

Luncheons are considered to be entertainment costs and are unallowable under the provisions of OMB Circular A-87, Attachment B (18). We identified 11 additional ineligible payments totaling \$1,586 for the Mayor's business lunches. We provided a list of the expenditures to the City during our fieldwork. Subsequently, on October 2, 2001, the City advised CPD that it reviewed vouchers for the years 1998 through 2000 and reimbursed its CDBG account \$3,370 from non-Federal funds. This amount represented the \$1,586 identified during our audit and an additional 7 items, totaling \$1,784, identified by the City.

During the audit, the City provided justification and documentation to CPD for the other categories of costs found to lack proper support (indirect costs; rent paid to the redevelopment authority; etc.) totaling \$72,306. We did not review these costs since they were beyond the scope of our audit and ultimately needed to be

resolved to the satisfaction of CPD. We noted, as of January 28, 2002, the \$72,306 in question was not yet resolved. On January 25, 2002, the Special Counsel provided additional information from the independent auditor that performed the City's Single Audit. Since the information applies to those costs, we forwarded it to CPD.

- d. **CDBG Funds Were Not Expended in a Timely Manner:** 24 CFR 570.902(a)(1) requires, 60 days prior to the end of the grantee's program year, the amount of CDBG funds available to the grantee, but not disbursed, be no more than 1.5 times the entitlement grant amount for the current program year. However, as of November 1, 1999, CPD determined the City had 2.57 times its 1999 program year grant in arrears and 2.1 times its 2000 program grant in arrears as of September 20, 2000. Thus, the City was failing to use its CDBG funds in an efficient and effective manner.

Since CPD believed it was unlikely that the City would achieve the 1.5 program year standard by November 1, 2000, by letter to the City dated October 25, 2000, CPD eliminated the need for the City to continue working toward the timeliness goal. Instead, CPD notified the City that CPD would continue to require the City to obtain approval prior to the expenditure of any CDBG funds until all of the deficiencies identified in its monitoring review and the pending audit report are resolved.

At the Exit Conference the Special Counsel asserted, that in part, the delay was caused by CPD's placing the extra requirement on the City to support their disbursements and obtain prior approval.

Violation of HOME Regulations

3. The following are violations of the laws and regulations that apply to the HOME Program:
 - a. **Davis-Bacon Act Requirements Not in Contract:** 24 CFR 92.354 requires every

contract for new housing construction that includes 12 or more units assisted with HOME funds to contain a provision requiring the prevailing wages of the locality be paid pursuant to the Davis-Bacon Act. We found the City did not include these provisions in contracts as required. Instead, we found the City attempted to avoid the requirement by issuing five contracts, two contracts were executed on the same day, and each of the five contracts was for less than 12 units. (See Appendix E for details.)

b. **Code Violations Not Corrected:** 24 CFR 92.251 and the City's rehabilitation procedures require correction of all code violations for dwellings rehabilitated with HOME funds. During physical inspections of five properties, we found two properties had existing code violations. At the Exit Conference, the City's Special Counsel stated the City took action to correct code violations identified during our physical inspections of rehabilitated properties. Accordingly, until CPD verifies that the repairs were made, these costs are considered questionable. (See Appendix C for details.)

c. **Ineligible Applicants Received Assistance:** For the City's Homebuyers Assistance activity, we found three of six homeowners we reviewed did not qualify for assistance because their family income exceeded established limits. (See Appendix E for details.)

City Did Not Establish
and Maintain Adequate
System of Internal Control

4. Internal Controls over Community Development programs are inadequate. OMB Circular A-102 Common Rule was codified by each Federal agency as the Grant Management Common Rule. This Rule requires non-Federal entities receiving Federal awards to establish and maintain a system of internal control designed to reasonably ensure compliance with Federal laws, regulations and program compliance requirements. We found the City's internal controls to be inadequate. Further, OMB Circular A-87 requires grantees to be responsible for the efficient and effective

administration of grants through the application of sound management practices. Each grantee is responsible for employing the organization and management techniques needed to assure proper and efficient administration of its programs.

During our review, we used OMB Circular A-133's Appendix B (Compliance Supplement), Part 6 (Internal Control) as a guide to identify the major characteristics of an internal control structure the City should have considered when establishing its internal control system. The following are the characteristics, at a minimum, the City should have considered.

- a. **Control Environment:** The responsiveness of management to prior questioned costs and control recommendations; management's respect for and adherence to program compliance requirements; a clear definition of key manager's responsibilities; adequate knowledge and experience possessed by key managers to discharge their responsibilities; staff's knowledge of compliance requirements and responsibility to communicate all instances of noncompliance to management; and management's commitment to competence ensuring staff receives adequate training to perform their duties.
- b. **Control Activities:** Operating policies and procedures are clearly written and communicated; supervision of employees commensurate with their level of competence; and personnel with adequate knowledge and experience to discharge their responsibilities.
- c. **Information and Communication:** Existence of adequate source documentation to support amounts and items reported; establishment of a record keeping system to ensure accounting records and documentation are retained for the period required by OMB Circulars, laws, regulations, contracts, and agreements applicable to the program; accessibility to

accurate information for those who need it; and effective communication of duties and responsibilities to employees.

Our review showed the City did not establish and maintain an adequate system of internal controls in administering its CDBG and HOME Programs. The specific weaknesses we identified during our review are discussed below in detail under parts B through H of this finding.

City Staff Lacked Direct Knowledge of Requirements, Training, and Supervision

- B. The City's staff lacked direct knowledge of program requirements, formal training, and supervision needed to administer the CDBG and HOME Programs.

Our review of six activities disclosed major deficiencies since staff did not know Federal laws and HUD regulations, and apparently did not take the time to research program requirements, laws and regulations as evidenced by the 22 instances of noncompliance with HUD regulations. (See Appendices A thru F).

Staff Lacked Knowledge of HUD Program Requirements

1. The City hired staff who had no direct knowledge of HUD program requirements:

- a. **Directors:** There was frequent turnover in the position of OECD Director. Since January 1996, three different individuals served in that position. There was no documentation in the City's personnel files to show the Directors were selected on a competitive basis.

Based on our review of the personnel files, we did not find any evidence that any of the three recent Directors, when hired, had any experience with HUD programs, rules, and regulations. Further, we did not find a copy of a completed job application or a resume on file for two of the three Directors.

- b. **Staff:** We reviewed the personnel files for three OECD staff members and did not find any evidence to show the City filled these positions competitively. Generally, these employees, when hired, lacked direct experience or

knowledge in HUD program's rules and regulations. We found neither a resume nor a completed job application on file for two of the staff members and only a copy of a resume on file for the third staff member.

- c. **Effect of Lack of Direct Knowledge:** Because staff was not experienced or properly trained, funds were not always spent on eligible activities. For example, the City loaned \$350,000 of CDBG funds to a developer to acquire and clear an abandoned, blighted factory complex knowing the plans included the subsequent construction of market-rate housing on the cleared property. They believed the cleared property could be used for any purpose once the spot slum and blight national objective was met. However, 24 CFR 570.208 (d)(1) and 24 CFR 570.505 (a) require a subsequent use of property acquired and cleared with CDBG funds be used to meet a national program objective. Since the housing constructed was planned and advertised to be market-rate and was stated not to benefit low and moderate-income persons, CDBG funds totaling \$350,000 were ineligible. (See Appendix F for details.)

Adequate Training Not
Provided

2. The City did not provide adequate training to staff on HUD programs/regulations. The OECD Directors and staff could have gained the needed experience and knowledge through formal training. However, neither the City nor OECD had a training policy or program. There was no requirement for employees to receive minimum levels of training on an annual basis. Rather, employees received training on a sporadic basis. We could not readily determine the degree of training afforded to the City employees because neither the City Personnel Department nor OECD maintained employee-training records.

We noted the City hired a Special Counsel to train the OECD staff. According to the Special Counsel, the OECD staff received training during two days in July 2001 and through continual one-on-one

interaction with the Special Counsel and his staff. The group training sessions covered basic CDBG and HOME statutory and regulatory requirements. The Special Counsel stated the training was informal and there was no syllabus. Counsel believes the staff now has an adequate level of understanding of the relevant laws and regulations to function at a sufficient level of proficiency to ensure compliance with requirements. However, the City did not accumulate the information needed to create employee-training records, such as, the number of hours of training provided in each subject area and a list of staff members attending each training session. Further, a copy of the handouts and materials used in the training was not retained in the City's file. Since the capacity of the staff has been an ongoing issue between CPD and the City, it would be prudent for the City to create and retain training records for the OECD staff and to retain copies of materials used in providing the training. By doing so, the increased proficiency of the staff can be verified and individual training needs can easily be identified.

The Special Counsel also encouraged the City to seek additional training offered by HUD or other organizations such as the Community Development Training Institute. We agree the City needs to supplement this foundational training with additional training on a regular basis.

Lack of Supervision

3. The day-to-day supervision of the City's CDBG and HOME Programs was not sufficient to ensure proper administration of the programs. We found the City's administration of the programs did not substantially comply with HUD regulations; activity files lacked evidence of supervisory review; supervisors did not approve time sheets and travel vouchers; and supervisors did not set work goals for employees or evaluate employee performance.
 - a. **Noncompliance with Policies, Procedures and Regulations Not Detected:** The OECD Director, Assistant Directors, and/or other City employees, who were directly or indirectly

responsible for the administration and/or coordination of all of or some of the City's CDBG and HOME Programs, did not implement a system of supervisory review that would have detected non-compliance with HUD's regulations and the City's policies and procedures. Our audit showed the City did not substantially comply with 22 specific HUD regulations, some with multiple occurrences, and did not follow the City's own procurement requirements and payment procedures.

- b. **Files Did Not Evidence Supervisory Review:** OECD's activity files contained no evidence of supervisory review. For example, our review of the City's OOSF rehabilitation program showed numerous deficiencies including: files were missing; files were disorganized; homeowner income was not always documented or computed correctly; cost estimates were not always documented; competition was not always sought; receipt and evaluation of bids was not controlled; inadequate inspections were performed; payments to contractors were not controlled; and waiting list and processing of applicants was not adequately controlled (See Appendix C for details). These type deficiencies would normally be detected through a supervisory review of the files. Discussions with OECD staff confirmed there were no supervisory reviews of the files. There were no procedures for performing quality assurance checks, at specific program milestones, to ensure appropriate actions were taken and the files were complete, adequately documented, and logically organized.
- c. **Time Sheets Did Not Evidence Review:** In response to CPD's monitoring review, OECD developed a unique time sheet for employees to report their time. The new time sheet was designed to accumulate detailed activity information for HUD reporting purposes. We reviewed the unique time sheets completed by the nine OECD employees for the two-week

period ending October 1, 2000 and compared them to the time records they prepared for payroll purposes. We found time charges reported on four of the nine time sheets did not agree with time charges reported on the corresponding payroll records for regular, sick and compensatory time. We also noted employees were not listing all information on the time sheet and/or were inconsistent in the method used to complete the time sheet. There was no evidence the time sheets were reviewed or approved by a supervisor or that the information reported was compared to the information on the payroll time records and the differences reconciled.

Further, the new time sheet did not include a dedicated space for a supervisor's signature. Also, the employees wrote or printed their names on the time sheets rather than sign them. We discussed this issue with the OECD Director during the audit and, based on our discussion, the Director revised the time sheet format to include spaces for employee and supervisor signatures.

- d. **Travel Expenses Did Not Evidence Supervisory Review:** We reviewed 14 OECD travel advances and related travel expenditures and found no evidence of supervisory review or approval. We found: receipts were not on file to support four vouchers; an employee was reimbursed for two trips without submitting a travel voucher; another employee traveled on official business in May 2000 but did not file a travel voucher until January 2001, after we raised the issue; in three cases travelers incurred expenses in excess of what we believed was reasonable and necessary; and, employee expense reports were not available for three employees. The City's travel voucher form did not have a dedicated space for the supervisor's signature and there was no other written notation on the vouchers to indicate the expenditures were reviewed and approved.

Also, we found the City does not have written established limits on the amount that can be expended for hotel and meals. We discussed these issues with the OECD Director during the audit and, as a result, the Director stated he would take action to develop a travel policy and procedure for OECD.

- e. **Supervisors' Staff Evaluation and Productivity Measurements Did Not Exist:** We reviewed nine employees' personnel files and did not find any ratings or evaluations of their performance. In our review of the City's OOSF rehabilitation program, we found the OECD Director could not provide any information relating to the productivity of the rehabilitation specialists. Also, OECD staff did not compile reports to measure productivity and there was no management information system available to provide the needed information. We also found OECD supervisors did not establish and communicate productivity goals to employees.
- f. **Waiting List Not Controlled:** There was a lack of supervision and control over the waiting list and processing of applicants into the OOSF rehabilitation program to ensure the program was being administered consistently and OECD's policies and procedures were followed.

We reviewed the waiting list and made the following observations: applicants were crossed off the list without explanation; a project number was assigned, yet the data fields for the applicant's name, address and phone number were blank; it appeared as though an entry for an applicant was inserted between existing entries on the list; and there was a discrepancy between the waiting list and the project file data. We also found the City assisted a homeowner who was not on the waiting list.

We found no evidence a supervisor reviewed the list or determined if City policies were being followed. Although some notations were made

on the list to identify the rehabilitation specialist working the case, this practice was not consistent. The waiting list did not provide space for including the: name of the specialist assigned to work the case; date the specialist began work; and final disposition date. OECD did not have any other document or system to monitor the processing of the cases.

We discussed our concerns about the waiting list with the OECD Director during the audit. The Director informed us the staff recently developed an automated waiting list. We examined the automated waiting list and found it does provide for identification of the rehabilitation specialist; however, at the time of our review that field was blank. Also, the automated list does not provide for the date the specialist began working the case or the date of final disposition.

Audit Process Delayed

4. The City did not always respond to auditor's requests timely. The completion of the on-site audit work was substantially delayed because documents needed by the auditors to complete their field work were not in the proper file and had to be requested from the City's staff. Further, several scheduled meetings with the OECD Director to discuss audit issues and provide periodic briefings were postponed and/or rescheduled.

At our Exit Conference, the City stated the delays occurred because the OECD Director and staff had to respond to HUD management on the issues in the monitoring review, locate requested information and records for the auditors, and continue to administer the program on a daily basis. The Mayor stated any delays and rescheduling of meetings occurred because OECD staff were under his instructions to administer the program properly while also responding to the auditor requests for meetings, to search for, and to prepare documents and explanations of the City's projects, policies and procedures.

City Lacked Adequate
Policies, Procedures, and
Management Tools

Key Written Policies and
Procedures Not
Established

C. The City did not have adequate policies, procedures, and other management tools in place to effectively administer its program in compliance with Federal laws and HUD regulations.

1. OECD needs to establish written policies and procedures. OECD did not have written procedures for processing purchase requests, traveling on official business, and time reporting. As a result, purchase decisions were not always adequately documented, controls over travel expenditures were lacking, and inaccurate time sheets were processed.

Prudent business practices prescribe that policies and procedures should be communicated in writing. The documentation aspect is critical because oral communication of policies and procedures is unreliable; spoken words can be changed too easily, forgotten or never even heard. Furthermore, the lack of written policies and procedures makes it difficult to assure new personnel are made aware of the policies and procedures that affect them.

We discussed these issues with the OECD Director during the audit. OECD developed policies and procedures for processing purchase requests, travel and time reporting during the audit. CPD reviewed the purchase procedures and determined they were generally acceptable and met the requirements at 24 CFR 85.36. We reviewed the travel procedures and noted they still needed to include supervisory approval of employee travel expenses. In addition, neither the purchase procedures nor the travel procedures were approved by City Council. The Director affixed adequate procedures for time reporting to the back of the time sheet form.

Existing Procedures Need
to be Updated

2. Although the City had written procedures for several functional areas over its administration of its CDBG and HOME Programs, we found they were often outdated, inconsistent, or not adequate and needed to be updated. Specifically, we identified deficiencies in the City's CDBG and HOME housing rehabilitation procedures, purchasing manual, and payment procedures.

- a. **Program Administration:** In the City's OOSF rehabilitation program, homeowners receiving grants and/or loans must certify occupancy of the rehabilitated property for the life of the grant and/or loan. For grants, homeowners make this certification by signing the mortgage agreement. However, the loan documents do not include occupancy provisions and the City does not have a separate certification form for loans. To be consistent, the City should include an occupancy certification statement in its loan documents.

In another example, the procedures for CDBG funded rehabilitation contained conflicting statements about the number of bids to be obtained. In one section the procedures state an applicant shall secure a single bid from an approved contractor and in another section the applicant will secure bids from contractors of his/her choice. Further, there were differences between the procedures for CDBG and HOME funded rehabilitation work. While the CDBG procedures require applicants to secure a single bid from an approved contractor, the HOME procedures allow only one bid if the homeowner insists, and the homeowner provides a signed statement including their rationale for having only one bid. (See Appendix C for details on rehabilitation procedures.)

We also found the procedures for the City's Economic Development activities needed to be revised to identify the employees responsible for obtaining, reviewing, and/or approving supporting documentation.

- b. **Procurement:** The City's purchasing manual was outdated. Although the responsibility for making small purchases (\$499 or less) was shifted from the Finance Department to the individual departments in the mid-1990's, this change was not reflected in the manual. In addition, there were at least five memoranda issued between 1980 and 2000 modifying the content of the manual. We believe the manual

was due for revision. We discussed this issue with the Finance Director during the audit. The Finance Director planned to revise the purchasing manual by the end of December 2001.

- c. **Payment:** OECD had inadequate payment procedures. Although staff performed certain tasks such as checking invoice amounts to contracts, verifying supplies or services were received, and taking advantage of offered discounts, these tasks were not a part of the written procedures. Other tasks, which were documented in the procedures, needed clarification to identify the employee responsible for performing the procedure. Yet, other procedures were simply omitted such as limiting the authority of the Assistant Directors for approving invoices, obtaining travel advances, filing travel claims and ensuring expenditures were reasonable and necessary, and consistent with activity objectives.

We briefed the OECD Director on these issues during the audit. The Director agreed to review the procedures and develop/revise them accordingly.

Accurate Management
Tools Not Maintained

- 3. Organizational charts and position descriptions are basic management tools. General business practices require organizational charts to be accurate and position descriptions to accurately reflect employees' duties. However, we found OECD's organizational chart and position descriptions were inaccurate. The organizational chart listed positions in a hierarchical arrangement but erroneously showed an Assistant Director and the Community Development Specialist reporting to OECD's secretary.

We reviewed three position descriptions and the three were incorrect. The position description for the Community Development Specialist did not include the tasks of processing payments and drawing down funds. The position description for one Assistant Director incorrectly included the

responsibility for supervising the housing rehabilitation program even though it was not that Assistant Director's responsibility. The position description for the other Assistant Director, who did supervise the program, made no mention of that responsibility.

We brought these deficiencies to the attention of the OECD Director and the Director provided a revised organizational chart and position descriptions during the audit. However, the revised position descriptions for an Assistant Director and the Community Development Specialist were still incomplete. We informed the OECD Director of this situation during the audit. Although the position descriptions were revised twice based on our discussions, we found the position descriptions for the Assistant Director and the Community Development Specialist were still incomplete.

City Lacked Adequate
Financial Management
System

D. The City lacked an adequate Financial Management System, as required by 24 CFR 85.20(b). The regulation requires grantees to meet standards for financial reporting, control and accountability for personal property and assets, and maintaining source documentation for accounting records. The City failed to detect and correct an accounting error in a timely manner, support a HOME fund drawdown, adequately control assets purchased with grant funds, and issue required Internal Revenue Service forms.

Accounting Error Not
Corrected Timely

1. The Finance Department did not detect and correct an accounting error in a timely manner. We reviewed the 1999 check register for the City's CDBG checking account and noted a check in the amount of \$210,116 was out of sequence. The check was issued to transfer funds from the City's General Fund to its Payroll Account to cover the biweekly payroll. Although the funds were physically drawn from the correct account, the Finance Department erroneously posted the check to the CDBG checking account on the City's books. The Controller's Office identified the erroneous posting while conducting routine bank reconciliations. The Controller verbally reported

Drawdown Not Supported

the discrepancy to the Finance Department for action in April 1999. However, the Finance Department apparently took no action until the City's independent auditors identified the discrepancy. The Finance Department made an adjusting entry on December 31, 1999, nine months later.

2. We reviewed 4 of the City's 32 drawdowns, against its 1998 and 1999 CDBG and HOME grants, totaling \$797,368. OECD staff provided supporting documentation for three drawdowns. However, supporting documentation could not be located for the fourth drawdown totaling \$165,000.

OECD personnel claimed the support could not be provided because of a problem with making entries into the Integrated Disbursement and Information System (IDIS) computer system. However, the source documents could not be identified because OECD did not maintain an adequate audit trail.

OECD needs to improve its record keeping for IDIS drawdowns. The Community Development Specialist factored program income into drawdown calculations for one of the drawdowns we reviewed. However, the specialist did not maintain supporting documentation for the program income figures used in the calculations. Without the documentation, there is no assurance the City maximized the use of its program income.

During the audit, we recommended to the OECD Director that the Community Development Specialist document all drawdown calculations, including supporting program income amounts. Also, all voucher numbers covered by the drawdown are to be listed. The OECD Director agreed it was prudent to leave an audit trail.

Adequate Property Management System Not Established (Inventory Control System)

3. 24 CFR 85.32(d) requires grantees to develop and implement procedures for managing equipment purchased with grant funds. At a minimum, grantees are required to maintain property records that include: description of the property; acquisition

date; serial number or other identification number; source of funds; custodian of the property; and, location, use, and condition of the property. The City did not maintain a current list that met those requirements. The inventory list maintained by the City was incomplete and out of date. Assets purchased with CDBG funds during our audit period, which were included in our review, totaling \$34,989 were not on the City's inventory. The items were six guns, three computers, a gun suppressor, and a vehicle. The City's independent auditors also noted the City's inventory system needed improvement. The City needs to establish and implement an inventory control system in compliance with HUD requirements.

Required IRS Forms Not
Issued

4. The City did not issue Internal Revenue Service (IRS) forms as required. The IRS requires payers to file Forms 1099-MISC for payments of \$600 or more made to independent contractors and partnerships in the course of trade or business. We reviewed 20 contractors who performed services for the City in 1999 and 2000. We found the City did not issue Form 1099 for 4 of the 20 contractors as required. As a result, payments totaling \$49,500 were not reported to the IRS. We discussed this issue with managers and the City issued the needed Forms 1099 during the audit.

City's Record Keeping
System Is Inadequate

- E. In general, we found the City's files to be incomplete and disorganized. This made it difficult to locate all the documents. In many cases, we had to request documents from City staff members who had to attempt to find them and at the same time perform their normal work activities. The inadequate condition of the City's files and the time taken to locate documents unnecessarily delayed our audit.

Personnel Files Were
Incomplete

1. The City's personnel files generally did not contain employment documents. We reviewed the personnel files for nine key current and former employees and did not find any of the files to be complete. Of the nine files reviewed, only two contained completed job application forms and only three contained resumes. None of the files

contained performance appraisals, training histories or evidence the candidates selected for the positions were selected through a competitive process.

The City needs to maintain better personnel records. Employee personnel files should contain completed job applications, resumes, performance appraisals and training histories. The City needs to document vacant positions were advertised, a pool of qualified applicants was created, the applicants were screened, and the most qualified candidate was selected for the job.

Activity Files Were Disorganized

2. We found the overall condition of the activity files substandard. CPD reported the same condition in its monitoring review. 24 CFR 570.506 and 24 CFR 92.508 requires grantees to maintain sufficient supporting documentation for their activities. Good business practice calls for files to: contain only pertinent information; have documents filed in a logical order; be tabbed, indexed and secured. We attempted to work with the activity files independently; however, we generally found documents were: filed haphazardly; not secured; not on file and/or could not be located. In addition, there was extraneous and/or duplicative documentation in the files. Consequently, we had to ask OECD personnel for assistance in locating some documents and had to request third parties to provide others. Because the files were poorly maintained, our audit was unnecessarily delayed. (See Appendices C and D for details on the condition of activity files.)

Procurement Requirements Not Followed

- F. The City did not follow the requirements of HUD's procurement regulations contained in 24 CFR 85.36 or of its own procurement policy.

Federal Procurement Requirements

1. The City did not adhere to the procurement requirements of 24 CFR 85.36. The manner in which the City executed its OOSF housing rehabilitation program triggered the application of requirements from 24 CFR 85.36. Rather than simply assist homeowners, the City became involved in the procurement process. For example,

the City may, at the homeowner's request, perform technical assistance such as collecting and summarizing contractor bids. However, we found this was not the case. The City routinely received contractor bids. We found no evidence in the files the homeowners requested this assistance. Further, the rehabilitation specialists solicited bids from contractors. When homeowners cannot handle the responsibility for contractor selection, and the grantee undertakes to procure the contractor for such persons, the transaction becomes bound by the requirements of 24 CFR 85.36.

24 CFR 85.36 requires all procurement transactions to be conducted in a manner providing full and open competition. We reviewed five rehabilitation projects and found evidence of adequate competition for only three. For one of the two remaining projects, the homeowner instructed the rehabilitation specialist to solicit a bid from only one specific contractor for a new roof and from a different contractor for the electrical work. For the remaining project, the homeowner instructed the rehabilitation specialist to solicit a bid from a specific contractor for all of the work.

With respect to procurements made under the Small Purchase method, we reviewed 11 small purchases (less than \$100,000) and found seven purchases were not supported by vendor quotes. 24 CFR 85.36 requires when small purchase procedures are used, price or rate quotations must be obtained from an adequate number of qualified sources.

City's Procurement Policy

2. The City did not implement or assure implementation of its procurement policy. In a 1992 memorandum from the Mayor, City departments were required to support purchases between \$100 and \$10,000 with more than one written quote and three written quotes were preferred. In an August 1999 Finance Department memorandum, all City departments were required to process a formal purchase order request for all purchases of \$500 or more. This memorandum reiterated the general rule that all purchases should

be supported by three quotes. We found OECD generally disregarded these policies and as a result violated the provisions of 24 CFR 85.36.

- a. **Purchase Orders Not Used:** We reviewed 10 purchases made by OECD greater than \$500 during the period August 1999 through December 2000. We found none of the 10 purchases were supported by a purchase order. The Finance Department's purchase order logs showed OECD only requested three purchase orders during 1999 and 2000 despite making over 130 purchases in excess of \$500. The OECD Director was aware of the requirement and explained that the staff simply did not obtain purchase orders. The City Finance Director was aware OECD was not in compliance with the policy but took no action to enforce compliance.
- b. **Price Quotations Not Obtained/Documented:** OECD needs to document price quotations solicited and received and its purchase decisions. Initially, we found 10 of 11 purchases reviewed were not supported by the preferred three written quotes and 1 of the 10 had two quotes. Subsequently, the Community Development Specialist provided quotes for 2 of the 9 purchases leaving seven purchases with no quotes at all. The specialist filed those quotes separately but could not provide any information for the other seven purchases. Again, the City Finance Director was aware OECD was not in compliance with the policies but took no action to enforce compliance.

Quotes from vendors and any analysis of the quotes should be recorded and filed with the payment documentation. In instances where a purchase is made sole source or if adjustments are made to written quotes, written notes or justifications should accompany the payment documentation.

City Did Not Adequately
Monitor Activities

G. 24 CFR 85.40 makes grantees responsible for monitoring their supported activities to ensure that funds are used in accordance with all applicable regulations. We found the City did not adequately monitor its activities. As a result, the City did not have the assurance that the funds were used in accordance with the regulations and for the purposes intended. For example:

The City did not monitor \$20,000 of CDBG funds it contributed toward the construction of a public facility. The facility was not completed in accordance with the plans specified in the proposal used for the funding request. (See Appendix B for details.)

Further, the City did not adequately monitor \$1,189,523 of HOME funds it provided to a developer for its Homebuyer Assistance program. We asked the OECD Director whether staff monitored this activity and to provide documentation. The Director provided no documentation and claimed that previous site inspections, meetings and phone conversations constituted monitoring. However, the inspections, meetings, and phone conversations did not ensure acquisition and construction costs were reasonable. (See Appendix E for details.)

Also, in CPD's 2000 monitoring review, CPD found the City performed limited, insufficient reviews of its subrecipients. CPD criticized the City for not having written procedures for monitoring subrecipients and required the City establish them. In response, the City created a Subrecipient Checklist and a Subrecipient Monitoring Plan. CPD cleared the procedures for use on March 7, 2001.

We attempted to verify the City's implementation of the new procedures since CPD approved them during the audit. We asked the OECD Director to provide documentation demonstrating implementation of the new procedures. The Director referred us to an Assistant Director who provided documentation pertaining to a CDBG funded Literacy Program at a local library. We found the Assistant Director generally monitored the activity in accordance with the new

City Did Not Fully
Disclose and Report
Details About Its CDBG
and HOME Funded
Activities to HUD

Blight Elimination

Community Policing

procedures. However, through discussion, we found the Assistant Director was not assigned the responsibility to monitor this activity. Rather, the Assistant Director took the initiative to perform the monitoring. The City needs to fully implement its monitoring procedures and ensure its activities are monitored as required.

H. The City did not fully disclose details about its CDBG and HOME funded activities in its annual plans, as required by 24 CFR 91.220 or its performance reports, as required by 24 CFR 91.520. We noted deficiencies for the following activities:

1. In its 1998 plan, the City informed both HUD and its citizens, CDBG funds would be used to demolish and clear an abandoned, blighted factory complex knowing the plans included the subsequent construction of market-rate housing on the cleared property. The City reported the complex was demolished and cleared in its 1998 and 1999 performance reports. However, neither the plan nor the reports disclosed the fact the subsequent use of the property was for market-rate housing. (See Appendix F for details.)

24 CFR 91.505 states grantees shall amend approved plans whenever there are changes in the purpose, scope or beneficiaries of an activity. It further states substantial plan amendments are subject to a citizen participation process. It also requires the grantee to make the amendment public and notify HUD of the change. However, the City did not disclose the details of this activity to HUD and its citizens although the subsequent use of this property for market-rate housing constituted a substantial change to the activity, as reported.

2. The City's 1996, 1997 and 1998 plans included Police Hiring activities. The purpose of these activities, as described in the plans, was to employ four additional police officers in low and moderate-income areas. However, the City purchased equipment and a vehicle with these funds. The City's 1998 plan also included a Community Policing activity. The purpose of this activity was

described as expansion of Community Policing initiatives in low/mod neighborhoods. However, the City used \$20,904 of these funds to pay for salary and benefit costs for two officers already on the police force.

Homebuyer Assistance

3. Although the City listed this activity in its 1998 plan to assist 10 households, there was no corresponding report for this activity in the City's 1998 report. This activity simply was not listed in the report. We determined the City assisted four homebuyers under this activity in 1998.

OOSF Rehabilitation

4. In its 1998 plan, the City set a goal to rehabilitate 20 housing units using a combination of CDBG and HOME funds. In its 1998 report, the City reported only five HOME funded housing units were assisted in 1998. We could not independently determine the number of housing units rehabilitated in 1998, so we requested OECD provide the data. The data provided by OECD indicated 16 housing units were assisted with CDBG and HOME funds in 1998, not the five reported.

CPD's Action Taken

- I. CPD performed a monitoring review of the City's CDBG Program in 1992 and questioned the City's ability to administer its program. In 1994 CPD performed a review of the City's rehabilitation program and recommended corrective action to address four program deficiencies. Further, in a June 2000 monitoring review, CPD noted the City's continued lack of capacity to administer its program and reported 13 findings in its monitoring report. The findings included noncompliance in maintaining supporting documentation; executing proper procurement transactions; monitoring subrecipients; performing underwriting; correcting code violations at homeowner properties rehabilitated with HOME funds; and meeting financial management system standards. These same six issues are discussed in this audit report. The other deficiencies identified in CPD's 2000 review included: conducting subsidy layering reviews, and documenting citizen participation.

In June 2000, CPD decided to closely monitor the City's administration of the programs and required the City to obtain prior approval for all expenditures, other than for payroll and two specific activities. Over the next several months, the City transmitted information and documentation to CPD in response to the 2000 monitoring review. Based on the City's responses CPD cleared nine findings in March 2001. However, in April 2001, due to the City's inability to resolve the remaining findings and demonstrate the capacity to plan and execute its programs, CPD augmented procedures and required the City to submit documentation for review and approval prior to the obligation and/or expenditure of CDBG and/or HOME funds.

In August 2001, CPD changed the City's funding stream from a letter of credit format, where the City would drawdown funding as needed, to reimbursement of local funds. However, the Assistant Secretary for Community Planning and Development revised the action in a September 5, 2001 letter to the City because the action carried with it the unintended consequence of stopping the City from executing its programs. HUD acknowledged the financial hardship and put the City back on the letter of credit format. The Assistant Secretary stated failure of the City to submit the required information in a satisfactory manner could result in limited access to advance funds. Also, continual failure by the City to submit such satisfactory documentation, or confirmation that current compliance problems continue without a satisfactory, voluntary resolution, may result in the termination, reduction or limiting the availability of current funds or it may result in reduction, withdrawal or adjustment to future grants.

The City's lack of adequate policies, procedures, control systems, and knowledgeable staff hindered the City's ability to effectively and efficiently administer its CDBG and HOME Programs as required. As a result of the City not developing a sound internal control environment to administer the CDBG and HOME Programs, five activities did not meet program eligibility requirements, two activities did not meet national objectives, more than \$2.6

million of CDBG and HOME funds was used on ineligible and unsupported expenditures and drawdowns, and details about funded activities were not fully disclosed in annual plans and/or reports.

Auditee Comments

The City provided comments in two parts, a letter from the Mayor and a detailed package responding to the Draft Report. The Mayor expressed his appreciation for the time and effort taken by the OIG to identify the problems and concerns with the City's internal control structure. The Mayor stated that after being appointed to office in November 2000, and working with the OECD Director, the City took action to retain Special Counsel experienced in the operation of the CDBG and HOME Programs. The Mayor asserted that the OECD Director, working with the Special Counsel and information provided by the auditors, has taken action to improve internal controls and has, and will continue, to submit additional documentation in response to the various issues raised. The Mayor also stated the City was developing alternatives to the interpretation of the program regulations that the City feels will substantially reduce the amount of unsupported and ineligible funds listed in the Audit Report.

The detailed response package consisted of seven sections addressing: Management Control Deficiencies; Community Policing Activities; Skateboard Park; Rehabilitation of Owner Occupied Single-Family Dwellings; Business Loan Guarantee; Homebuyer Assistance; and Blight Elimination. The majority of the information/documentation the City provided could be categorized as corrective actions taken and planned, justification for expenditures, and/or justification of changes from the eligibility basis upon which the activity was originally funded.

With regard to corrective actions taken and planned pertaining to the Management Control Deficiencies, the City stated it has made a number of improvements and began a review of its policies, procedures and systems to ensure that the City operates its programs in an efficient and effective manner. Further, the City commented on each recommendation, agreeing to take appropriate corrective

action. With regard to the recommendation requesting repayment of ineligible and unsupported costs, the City stated it will continue to provide documentation and urge interpretations of applicable requirements to support those costs, and if it is determined that amounts are owed, it will repay those amounts to the City's Federal program.

For five of the activities we reviewed, (Community Policing, Skateboard Park, Business Loan Guarantee, Homebuyer Assistance, and Blight Elimination), the City provided information, comments, statements, and documentation to justify expenditures and/or justify a change from the eligibility basis upon which the activity was originally funded. Also, the City questioned the accuracy of some figures included in the illustrations in the audit report and the information supporting some audit opinions/conclusions reached by the auditors.

A complete unedited copy of the City's response is included as Appendix H.

OIG Evaluation of Auditee Comments

We reviewed the City's detailed response; validated the points of issue to the documentation we gathered during our fieldwork; and made modifications to the report where appropriate. Most of the information the City provided was compiled after the issuance of our discussion draft report dated December 7, 2001. However, the information provided does not materially change the facts, conclusions, or recommendations contained in this report.

The City stated studies and surveys were completed to support its current position, and the City provided the results of the surveys/studies in its response, but did not provide any documentation to support those studies. Also, the City's comments included statements or presented information that directly contradicted statements and information the auditors obtained from the City's files and City employees. Therefore, additional audit work would be required to evaluate the presentations made by the City. In addition, the City's comments justifying changes to the eligibility basis upon which activities were originally funded would have to be reviewed, evaluated, and approved/disapproved by CPD. Both issues can be evaluated by CPD during its monitoring of the City and through the Audit Resolution process.

We provided CPD a complete copy of all the documentation provided to us by the City since the exit conference.

Recommendations

We recommend CPD:

- 1A. Verify repairs were made to correct code and safety violations at the two residences rehabilitated with HOME funds and, if not, the \$16,455 should be refunded to the program.
- 1B. Request an opinion from the Department of Labor on whether Davis-Bacon Act provisions apply to the HOME funded Homebuyers Assistance activity.

We also recommend CPD direct the City to:

- 1C. Continue submitting all supporting documents to demonstrate activities being funded are in full compliance with all applicable Federal program requirements, until such time as the City demonstrates the capacity to administer its programs without supervision.
- 1D. Repay \$2,060,594 from non-Federal funds for the ineligible expenditures for the five program activities identified in this report.
- 1E. Demonstrate the Community Policing services provided were either new services or quantifiable increases in the levels of existing services or repay \$394,735 from non-Federal funds.
- 1F. Provide documentation to support the \$165,000 HOME drawdown or repay that amount from non-Federal funds.
- 1G. Implement monitoring procedures for all new and ongoing activities.
- 1H. Develop an automated waiting list for housing rehabilitation that provides useful information such as: the name of the specialist assigned to work the

project; the date the specialist began working the project; and the final disposition date of the project.

- II. Develop the policies, procedures or tools needed to improve control over operations including procedures:
 - (1) for supervision and oversight of rehabilitation employees and the rehabilitation program. These procedures should include, for example, documenting supervisory reviews, establishing productivity goals for employees, and monitoring and appraising employees' performance in the achievement of these goals.
 - (2) for quality assurance controls to monitor the quality of rehabilitation employees' work. This would, for example, include controls to ensure applicant's eligibility criteria, including income, are documented, rehabilitation inspections are thorough, cost estimates are documented, and rehabilitation files are reviewed to ensure they are complete, logically organized, and neat.
 - (3) for reviewing activities to related regulations to ensure CDBG and HOME funds are used only for eligible activities.
 - (4) for processing purchase requests by OECD, including requirements to document competition, maintain written justifications for sole source purchases, and properly document adjustments or modifications to bids submitted by vendors.
 - (5) for maintaining complete and up to date personnel files, including employee training records.
 - (6) for supervisory review and approval of employee travel expenses.
 - (7) for determining income eligibility for the Homebuyers Assistance program, using a consistent method, which provides and documents all information available and used to determine the homebuyer's income.

1J. Revise policies and procedures in the following areas:

- (1) OOSF housing rehabilitation: These procedures should, for example, require preparation of cost estimates, obtaining competitive bids, and receipt and control of bids.
- (2) Economic development activities: These procedures should, for example, include assigning responsibility for obtaining and reviewing all required application documents, conducting verifications to ensure the project is meeting a national objective, and maintaining documentation to evidence compliance with the procedures.
- (3) OECD payment procedures: Include documenting calculations of drawdown amounts and support for amounts included as program income.
- (4) Procurement policy: The City's procurement policy/manual should include all procurement related directives, memorandums, etc., issued since the issuance of the original policy. The City should include the procurement requirements of 24 CFR 85.36 in the policy, or if the City does not want to include those provisions on a citywide basis, establish such a policy for OECD to follow.

A copy of the revised City approved policies should be sent to CPD.

1K. Include an owner occupancy certification statement in the loan document for the properties rehabilitated with CDBG or HOME loans. Owners that have loans, which exceed five years, should be required to certify they are still occupying the property every five years.

1L. Identify training needs and establish a formal training plan, with annual training requirements, to address staff training needs.

- 1M. Review all OECD position descriptions and revise as needed.
- 1N. Establish performance standards by which all OECD staff are to be evaluated and ensure appraisals are completed annually and documented in personnel files.
- 1O. Establish an adequate file system for personnel records and activity documentation.
- 1P. Create an inventory control system in compliance with HUD regulations.
- 1Q. Establish training records for each OECD staff member and retain on file, copies of handouts, documents, slides, charts, etc., to support the training provided and for future reference/use. The training record should include items such as, dates of training, subject area, and number of training hours for each subject.

We also recommend, if the City fails to submit the required information and satisfactory documentation in support of the Federal Line of Credit System drawdowns, or if current compliance problems continue without a satisfactory, voluntary resolution as stated in a letter dated September 5, 2001 to the City from the Assistant Secretary for CPD, you should:

- 1R. Report your findings to the Assistant Secretary so action can be taken to: (1) limit the City's access to the drawdown system; or (2) terminate, reduce, or limit the availability of current funds; or (3) reduce, withdraw, or adjust future grants to the City.

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Management Controls

In planning and performing our audit, we considered the City's system of internal control (management controls) in order to determine our audit scope and procedures. Management is responsible for establishing effective management controls, which includes the organizational plan, methods, and procedures to ensure its goals are met. Management Controls include the process for planning, organizing, directing, and controlling program operations with procedures in place to provide reasonable assurance the City is in compliance with the applicable laws, regulations, and the provisions of contracts and grant agreements. Management is also responsible for assuring transactions are properly recorded and accounted for to: permit the preparation of reliable financial statements and Federal reports; maintain accountability over assets; and demonstrate compliance with the laws, regulations, and other compliance requirements.

Significant Controls

We determined the following management controls were relevant to our audit objectives:

- Compliance with regulations – Policies and procedures management has implemented to reasonably ensure resource use is consistent with regulations.
- Program administration – Policies, procedures, control systems, and other management tools implemented to ensure the program meets its objectives.
- Experience of management and staff – Policies and procedures implemented for hiring knowledgeable candidates and/or providing training to employees in order to achieve an effective and efficient administration of the City's program.

Significant Weaknesses

A significant weakness exists if management controls do not provide reasonable assurance the entity's goals are met; the use of resources is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, misuse; and reliable data are obtained, maintained, and fairly disclosed in reports.

Our audit disclosed the following significant weaknesses:

- Compliance with regulations – The City did not: (1) ensure two CDBG funded activities met one of the program's national objectives; (2) maintain documentation to demonstrate compliance with

requirements; (3) perform required assessments; (4) adequately monitor activities; (5) assure Davis-Bacon wages were paid; (6) correct all existing code violations; (7) ensure HOME funds benefited only eligible families; (8) fully disclose the scope and accomplishments of its activities; and (9) expend CDBG funds in a timely manner.

- Program administration - The City did not: (1) provide sufficient day-to-day supervision of its CDBG and HOME Programs; (2) establish written policies and procedures for OECD for processing purchase requests, traveling on official business, and time reporting; (3) update policies and procedures for housing rehabilitation, economic development activities, purchasing, and payment of invoices; (4) maintain a current OECD organizational chart and position descriptions; (5) follow procurement requirements; (6) establish an adequate financial management system; (7) establish an adequate record keeping system; (8) disburse CDBG and HOME funds for only eligible activities; (9) adequately monitor activities; and (10) accurately disclose details in the plans and reports.
- Experience of management and staff - The City did not: (1) hire OECD management and staff with direct knowledge of HUD programs and regulations; and (2) require OECD staff to receive minimum levels of training on an annual basis.

Follow Up On Prior Audits

This is the first Office of Inspector General (OIG) audit of Williamsport's CDBG and HOME Programs.

The most recent single audit report, for the year ending December 31, 1999, contained no findings pertaining to the HUD-funded programs.

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Community Policing Activities

Background

The City of Williamsport was awarded a three-year grant from the United States Department of Justice (DOJ) to pay salary and benefit costs to hire four law enforcement officers under its Community Policing initiative. The City applied for and received 50 percent of the cost from DOJ. The City planned to use CDBG funds for their matching contribution and the City's Bureau of Police subsequently hired four new officers.

In order to obtain the funds for its matching contribution, the City budgeted \$399,000 for salaries and benefits for four officers in its CDBG Annual Plans from 1996 through 1998 under Police Hiring activities. The City budgeted \$25,000 in its 1998 plan to expand its Community Policing initiative. As of October 2000, the City spent \$421,468 of the \$424,000 it budgeted for the four activities. We reviewed payments totaling \$415,806 since CPD included a payment of \$5,662 in its monitoring review, disallowed that amount, and the City repaid the funds.

Criteria

The City used 24 CFR 570.201(e) and 24 CFR 570.208(a)(1) to qualify its Community Policing activities.

24 CFR 570.201(e) states for crime prevention to be eligible for CDBG funding, the service provided must be either a new service or a quantifiable increase in the level of an existing service, above that which has been provided by or on behalf of the unit of general local government, in the 12 calendar months before the submission of the annual plan.

24 CFR 570.208(a)(1) states for area benefit activities to meet a national objective, the activity must be available to all residents in a particular area, where at least 51 percent of the residents are low and moderate-income persons.

24 CFR 570.506 requires recipients to establish and maintain sufficient records to document whether the recipient has met program requirements.

OMB Circular A-87 provides principles for determining allowable costs for Federal awards. The Circular, at Attachment A (A)(2)(a)(2), states governmental units are responsible for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award. Further, the Circular, at Attachment A (C)(1)(a), states to be allowable under Federal awards, costs must be necessary and reasonable.

Results

Documentation Not Maintained: The City could not demonstrate compliance with eligibility requirements and national program objectives. The City did not prepare documentation to demonstrate its Community Policing activities:

- constituted either new services or quantifiable increases in the level of existing services, above that which has been provided by or on behalf of the unit of general local government, in the 12 calendar months before the submission of the annual plan; and
- provided services to residents in areas where at least 51 percent of the residents were low and moderate-income persons.

We reviewed the activity files for the City's 1996, 1997, and 1998 Police Hiring activities and the 1998 Community Policing activity. We found no documentation in the files to demonstrate compliance with eligibility and national objective requirements, contrary to HUD regulations and OMB Circular A-87. We asked the OECD Director and Police Chief to provide the documentation, if available. However, neither the Director nor the Chief had the documentation. They could not explain why the documentation was not prepared because the City no longer employed the responsible managers. As a result, expenditures of CDBG funds for salary and benefit costs, and equipment totaling \$377,991 were unsupported.

Other Costs: Although the City's Annual Plans included budgets for salary and benefit costs to hire four police officers, the City used \$37,815 of the \$399,000 budgeted to purchase a vehicle (\$21,071), and uniforms and supplies (\$16,744). These items should have been budgeted separately in the City's plans. Furthermore, the City did not demonstrate the use of these funds met one of the national objectives or constituted either a new service or a quantifiable increase in the level of existing service, contrary to HUD regulations and OMB Circular A-87. Although we concluded the payment for the uniforms and supplies was unsupported, we concluded the payment for the vehicle was ineligible because the City had no records documenting the actual usage of the vehicle since it was first put into service in 1996.

Summary

We reviewed payments totaling \$415,806 for the City's Community Policing activities and found \$394,735 of that amount unsupported and \$21,071 ineligible. The following table illustrates the breakdown:

Expense	Ineligible Costs	Unsupported Costs
Salary, benefits, and equipment		\$377,991
Vehicle	\$21,071	
Uniforms and supplies		\$16,744
Total	\$21,071	\$394,735

At the Exit Conference, the City's Special Counsel provided a copy of a map identifying the City's Community Policing areas and a worksheet showing the calculations made to determine the percentage of low and moderate-income persons residing in those areas. We consider this documentation sufficient to demonstrate the benefit to low and moderate-income persons. We note, however, this documentation should have been available in OECD's files during our initial review.

The City's Special Counsel asserted that expenditures for salary and benefit costs under the Police Hiring activities were eligible, and provided a copy of a January 1995 letter from the City to CPD as support. However, the subject of the letter is the City's request for an exception to the public service regulations for police protection. Although the letter refers to the City's police staffing levels at that time, we do not consider this documentation sufficient to comply with the program's documentation requirements, because the accuracy of the figures used in the letter cannot be verified, nor can the level of existing services in the 12 calendar months before the submission of the annual plan be established. Further, since the City was requesting an exception to use CDBG funds to maintain the employment of five police officers already on the police force, the asserted increase in the overall City police staff level has not been established and remains questionable.

Also, the City's Special Counsel claimed the purchase of the vehicle, uniforms, and supplies did not have to be justified independently of the services being provided. However, the City established "Police Hiring" activities in its 1996, 1997, and 1998 action plans against which the expenditures were made. The City described the objective of those activities as employment of four additional police officers in low and moderate-income areas. HUD and the residents of the City rely on the accuracy of disclosed data to evaluate the City's plan and provide a basis for assessing performance. Moreover, during our audit, we found no documentation to demonstrate these items principally benefited low and moderate-income persons. The City's Special Counsel suggested the expenditures could be justified by having the Chief of Police, who was the former officer-in-charge of the City's Community Policing force, provide an affidavit attesting to the fact the vehicle was used only in low and moderate-income areas. In our opinion, this documentation would not be sufficient to comply with the program's documentation requirements. Counsel also claimed the uniforms and supplies were justified and eligible, but provided no documentation to demonstrate how the items were related to a new or increased level of services principally benefiting low and moderate-income persons.

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Skateboard Park

Background

The Williamsport Housing Authority (WHA) requested \$99,268 of 1999 CDBG funds from the City for construction costs associated with its proposed skateboard park. The City reviewed the proposal, decided to contribute a fixed amount toward the project, and included a \$20,000 skateboard park activity in its 1999 CDBG Annual Plan.

Criteria

The City used 24 CFR 570.201(c) and 24 CFR 570.208(a)(1) to qualify this activity.

24 CFR 570.201(c) allows for the acquisition, construction, reconstruction, rehabilitation, or installation of public facilities whether carried out by the grantee or other public or private nonprofit entities.

24 CFR 570.208(a)(1) states for an area benefit activity to meet national objective criteria, the benefits of the activity must be available to all the residents in a particular area, where at least 51 percent of the residents are low and moderate-income persons.

The CDBG Low/Mod Income Area Benefit criteria state an accurate determination of the area served by an activity is critical for complying with national objectives. Factors to consider when determining a service area include:

- the nature of the activity – its size and how it is equipped.
- the location of the activity - when a facility is located near the boundary of a particular neighborhood, its service area would be expected to include portions of the adjacent neighborhood as well as the one in which it is located.
- accessibility issues - for example, if a river or an interstate highway forms a geographic barrier that separates persons in an area in a way that precludes them from taking advantage of a facility that is otherwise nearby, that area should not be included in determining the area served.
- availability of comparable activities - the nature, location, and accessibility of comparable facilities. In most cases, the service area for one activity should not overlap with that of a comparable activity.

24 CFR 570.506 requires recipients to establish and maintain sufficient records to document whether the recipient has met program requirements.

24 CFR 570.501(b) requires recipients to monitor the performance of its subrecipients.

OMB Circular A-87 provides principles for determining allowable costs for Federal awards. The Circular, at Attachment A (A)(2)(a), states governmental units are responsible for the efficient

and effective administration of Federal awards through the application of sound management practices and governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award. Further, the Circular, at Attachment A (C)(1)(j), states, to be allowable under Federal awards, costs must be adequately documented.

Results

Documentation Did Not Demonstrate Compliance With Requirements: The City did not comply with eligibility requirements and national program objectives, contrary to HUD regulations and the principles of OMB Circular A-87. The City identified the public facility criteria as its eligibility citation for this activity. However, the WHA considers itself to be a private entity even though it is incorporated under State Law as a Public Non-Profit corporation. The OECD's file contained a June 2000 letter from the Director of the WHA to the OECD Director clearly stating the skateboard park was built on private property, was not a public facility, and any perception the WHA was obligated to anyone, other than its residents, was simply wrong. We did not find any information on file that the park was ever dedicated to the City or for the general use of all the residents of Williamsport.

HUD regulations allow for CDBG funds to be used on public facilities. The OECD Director dismissed the letter. The Director believed the skateboard park was a public facility; it was open to the public and would always be open to the public. We found no provision regarding public access in the subrecipient agreement. We found no other agreements with the WHA pertaining to skateboard park.

The City determined this activity would meet national objective requirements by providing an area benefit, to an area, where at least 51 percent of the residents were low and moderate-income persons. This was the only skateboard facility located in Williamsport and the surrounding community. However, the City did not determine an appropriate service area for the facility. That is, the service area designated by the OECD was used to solely qualify the project rather than employ an approach utilizing the factors listed in the CDBG Low/Mod Income Area Benefit criteria.

Documentation in OECD's file included a map showing the service area for the skateboard park. The perimeter of the service area was irregular. The service area meandered through nearby neighborhoods. That is, the service area included neighborhoods where at least 51 percent of the residents were low and moderate-income persons even though those neighborhoods were geographically further away from the facility than adjoining neighborhoods where less than 51 percent of the residents were low and moderate-income persons. There was no justification for including some neighborhoods and excluding others.

Using the factors listed in the CDBG Low/Mod Income Area Benefit criteria, such as adjoining neighborhoods and geographical boundaries of the surrounding area as a guide, we identified four possible service areas for the skateboard park. Our results showed this activity would not qualify for CDBG funding because the minimum 51 percent low/mod percentage criteria would

not be achieved. The low/mod percentages we calculated ranged from a low of 46.2 percent to a high of 48.5 percent.

The City Did Not Monitor the Activity: The City's subrecipient agreement, dated October 1999, required the WHA to expend all of the CDBG funds in accordance with a list of work tasks attached to the agreement. The work tasks included expenditures for sidewalks, fencing, lighting, bleachers, restrooms, and additional rides for younger children. However, a funding report submitted by the WHA to the City in May 2000 showed that the funds were used mostly for other expenditures associated with the project. Our physical inspection of the facility showed there were no restrooms, bleachers, or lighting installed.

The OECD Director said he monitored this activity. However, there was no monitoring report documented in the file. The only documentation, closely related to monitoring, was a copy of an undated checklist, which indicated the subrecipient spent the funds in accordance with the terms of the agreement, and a January 2000 memorandum documenting a visual inspection of the skateboard facility by an OECD rehabilitation specialist. The memorandum did not address the list of work tasks contained in the subrecipient agreement.

The OECD Director said the list of work tasks included in the subrecipient agreement, which was approved by City Council, was inaccurate. The Director claimed the WHA provided a second list of work tasks for this project and the second list should have been attached to the subrecipient agreement. The Director admitted he should have presented City Council with a modified agreement for their approval. However, there was no document in OECD's file explaining that the funds would be used for other expenditures. Furthermore, the Director did not provide a copy of the second list of work tasks during the audit.

The October 1999 subrecipient agreement also required the WHA to forward current invoices to the City for payment for expenses incurred in accordance with the terms of the agreement. Upon receipt of the invoices, the City would review them and determine whether they were due and payable. If after the review, the invoices were determined to be due and payable, the City would pay the invoices. Implementation of these procedures would facilitate the City's monitoring of the subrecipient's performance.

However, rather than abide by the terms of its own subrecipient agreement, in November 1999, the City made a single payment of \$20,000 to the WHA for labor and material costs, based on WHA's invoice that lacked adequate information. Contrary to the principles of OMB A-87, the WHA invoice was processed for payment despite a lack of detail and/or supporting information.

Summary

Contrary to the principles of OMB A-87, the City spent CDBG funds on a skateboard park activity that did not qualify for assistance and the City did not ensure CDBG funds it contributed were actually spent on this activity. HUD regulations require funded activities meet program requirements and recipients monitor the performance of their subrecipients. Since the activity did not qualify for assistance, the expenditure of CDBG funds totaling \$20,000 was ineligible.

At the Exit Conference, the City's consultant asserted that this project was eligible for funding under eligibility citation 24 CFR 570.202(a)(2). However, the citation addresses Rehabilitation and Preservation activities, and allows funds to be used for rehabilitation of low-income public housing and other publicly owned residential buildings and improvements. We believe this citation does not apply in this case because the project did not involve the improvement or rehabilitation of publicly owned residential buildings.

The City's Special Counsel provided a revised map showing the location of the skateboard park and contended the correct service area was the neighborhood in which the facility was located and an adjoining neighborhood in which a WHA housing complex was located. However, we believe Counsel's limited service area was too restrictive. We believe since this facility is the only one of its kind within the City limits and the surrounding area, some consideration must be given to the other adjoining neighborhoods. Using the factors listed in the CDBG Low/Mod Income Area Benefit criteria as a guide, we identified four possible service areas for the skateboard park and our results showed this project did not meet the area benefit criteria.

Also at the Exit Conference, the City's Special Counsel asserted the majority of users of the facility were low and moderate-income residents of the WHA. However, Counsel provided no documentation such as usage statistics or surveys to support that assertion.

Rehabilitation of Owner Occupied Single-Family Dwellings

Background

In 1998, the City budgeted about \$442,000 of CDBG and HOME funds for its various rehabilitation programs. Of that amount, the City budgeted \$201,000, or 45 percent, for its owner occupied single-family rehabilitation program. As of November 2000, the City revised its 1998 budget due to competing priorities and planned to spend \$96,800 for its owner occupied single-family rehabilitation program and spent \$78,347 of the \$96,800. At that time, there were about 80 applicants on the City's waiting list. Some of these applicants were waiting for assistance as long as 15 months.

We reviewed owner occupied single-family properties rehabilitated with 1998 CDBG and HOME funds. There were nine properties rehabilitated with these funds in 1998. CPD previously reviewed four of these properties in their monitoring review and found deficiencies. We limited our tests to the remaining five properties. Of the five properties, the City used CDBG funds to rehabilitate three properties and HOME funds to rehabilitate two properties. We performed physical inspections of the five properties and reviewed OECD's records. Contractors completed work on four of the five properties. Work was in progress for the remaining property.

Criteria

24 CFR 570.202 authorizes municipalities to use CDBG funds in the form of grants and loans to assist owners to rehabilitate homes, and 24 CFR 92.1 authorizes municipalities to use HOME funds in the form of grants and loans to assist owners to rehabilitate homes. These funds can be used to assist low-income homeowners to pay for labor, materials, and other rehabilitation costs including repair directed toward an accumulation of deferred maintenance, replacement of fixtures, installation of smoke detectors, renovations, enhancement of existing structures, and improvements to increase the efficient use of energy, such as the installation of siding and insulation. In general, the purpose of the rehabilitation program is to expand the supply of decent, safe, and affordable housing for low and moderate-income households.

24 CFR 570.506 and 24 CFR 92.508 requires grantees to establish and maintain sufficient records to document whether the grantee has met program requirements.

OMB Circular A-87 provides principles for determining allowable costs for Federal awards. The Circular, Attachment A (A)(2)(a), stipulates governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices. Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award. Furthermore, each governmental unit, in recognition of its own unique combination of staff, facilities, and experience, will have the primary responsibility for

employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards.

The City's CDBG Owner Occupied Single-Family Rehabilitation Program Procedure, dated September 1989 and revised December 1992, provides guidance to city officials for implementing Federal law and HUD regulations relating to CDBG funded rehabilitation projects. The City's 1998 HOME Owner Occupied Single-Family Rehabilitation Program Manual provides guidance for implementing Federal law and HUD regulations relating to the HOME funded rehabilitation projects. The procedures are similar and provide for grants of up to \$7,500 for qualified owner occupants as well as for 10 year and 20 year loans. The value of grants and loans are determined based on the income of the occupants and the cost of repairs. The maximum amount of loans and grants for a rehabilitation project is \$17,500.

24 CFR 92.251 requires HOME assisted rehabilitated housing comply with all local building codes at the time of completion. In addition, the participating jurisdiction must have written standards for rehabilitation that ensure HOME-assisted housing is decent, safe, and sanitary. The City's procedures reiterate this guidance and state the funds can also be used to increase and maintain property as an asset to the community.

Process: An applicant desiring rehabilitation assistance makes their request known to OECD personnel. The personnel record the applicant's name, address, phone number, and date of initial contact on a sequentially numbered waiting list. One of the rehabilitation specialists contacts the applicant by phone or mail to arrange for an interview. During the interview the applicant's eligibility is determined.

The City's rehabilitation procedures address: program eligibility, an inspection of the property to determine work to be performed, preparation of cost estimates, selection of contractors to submit bids and the mailing of bids, receipt and evaluation of bids, loan and grant approvals, awarding of contracts, progress inspections of the ongoing work, payment for work performed, and post inspections on an optional basis.

Results

Physical Inspection and Review of Records

Homeowner Income Not Documented and Computed Correctly: The rehabilitation specialists did not always document and compute household income as required by 24 CFR 570.506 and local procedures for CDBG funded rehabilitation projects. In one instance, the documentation supporting a homeowner's social security income was not included in OECD's file. The rehabilitation specialist said it was an oversight. In another instance, the rehabilitation specialist did not compute the annualized income of a homeowner despite requirements to do so. The specialist said he did not annualize the income because the homeowner's job was temporary and he was not sure what the homeowner's actual income would be. As a result, the homeowner received a \$6,374

grant. However, the homeowner was only entitled to a \$3,500 grant and the City should have offered the remaining \$2,874 as a loan.

Specialist Ignored City's Procedures: One grant was awarded for a home that was not in a targeted (low-income) area despite a requirement in the City's procedures that rehabilitated homes be in targeted areas. The rehabilitation specialist said OECD personnel decided, in 1998, not to follow the City's procedures, as they related to targeted areas, because HUD did not restrict the use of funds to targeted areas. The City needs to revise and up-date its procedures.

Code Violations not corrected: During physical inspections of the five properties, we found two HOME funded properties, with rehabilitation work totaling \$16,455, had existing code violations. 24 CFR 92.251 and the City's procedures require correction of all code violations for HOME funded properties.

For one property, the rehabilitation specialists did not identify a sagging bedroom floor during the initial inspection. The OECD Director said these deficiencies might not have been present before the completion of the work. However, we believe these conditions existed at the time of the initial inspections. The total rehabilitation cost was \$6,580 (Grant \$3,500 and Loan \$3,080).

For another property, the rehabilitation specialists did not identify cracked stairs during the initial inspection. Also, during our inspection of that property, we noted the homeowner removed a wall and a door installed by a contractor as part of the HOME funded rehabilitation program. The wall and door, estimated to cost \$475, was needed to remove a code violation. The total rehabilitation cost for the structure was \$9,875 (Grant \$5,000 and Loan \$4,875).

Cost Estimates Not Thoroughly Documented: Although the City's procedures require the rehabilitation specialists to prepare cost estimates, only two of the five projects' files reviewed contained completed cost estimate worksheets. Another project's file contained partially completed worksheets detailing only \$148 of a \$10,342 estimate. For the remaining two projects, there were no cost estimate worksheets in the file.

Competition Was Not Always Sought: The rehabilitation procedures did not require obtaining competitive bids for necessary work. Despite the procedures, adequate competition was obtained for three projects, but was not obtained for the two remaining projects reviewed. For one project, the homeowner instructed the rehabilitation specialist to solicit a bid from only one specific contractor for a new roof and from a different contractor for the electrical work. For the remaining project, the homeowner instructed the rehabilitation specialist to solicit a bid from a specific contractor for all work. 24 CFR 85.36 requires all procurement transactions to be conducted in a manner providing full and open competition.

In addition, specialists did not have the homeowner's document, in writing, which firms were to receive solicitations even though OECD had a specific form available for this purpose.

Receipt and Evaluation of Bids Not Controlled: Rehabilitation specialists opened bids when received, rather than placing the unopened bids in a secure container and opening all bids at the same time in the presence of the homeowner. General business practice is to secure bids until the bid opening and to open all bids at the same time by a designated official. We also noticed OECD employees did not time stamp the bids or their envelopes when the bids were received, even though required. Furthermore, the standard bid forms did not provide space for contractors to date their bids.

Grant Approvals Not Documented: Approval by the City's Loan Committee was not documented in one project file for a CDBG funded grant. Although the City's HOME rehabilitation procedures required the Loan Committee's review of the grant application for HOME funded projects, the CDBG procedures did not. Review of the grant applications by the Loan Committee would provide additional oversight and would be a beneficial control.

Awarding of Contracts Not Controlled: For one of the five projects reviewed, the rehabilitation specialist instructed a contractor to initiate work without knowing if the Mayor and Controller approved the contract. The City's procedures require the Mayor and Controller to approve the contracts before the specialists can authorize contractors to begin work.

We also noted the contracts do not provide spaces for any of the signatories to date the contract. Hence, all signatures were undated. General business practices are for signatories to date their signature.

Progress Inspections Not Satisfactorily Documented: For four of the five projects reviewed, rehabilitation specialists did not record inspections on standard inspection reports. Inspection reports provide details of contractors' job performance and their use is a standard construction industry practice. The files contained evidence that specialists made some unannounced inspections during ongoing projects, and homeowners and rehabilitation specialists also inspected work before making payments to contractors. However, the evidence often did not provide details as to the status of ongoing work. In addition, for one project there was no evidence of inspections other than to verify the completion of specific tasks prior to making payments.

Inadequate Progress Inspections: For one residence, City inspections failed to disclose work deficiencies. During our inspections, we found pieces of siding had blown off and insulation fell down behind the siding because the contractor did not securely fasten the siding and insulation to the house. The rehabilitation specialist said he failed to detect these and other deficiencies due to hidden defects and oversight.

Payments to Contractors Not Controlled: For one of the five projects reviewed, a copy of the contract and the winning contractor's bid were not in file. The rehabilitation specialist said the contract and winning bid were lost. However, the rehabilitation specialist made progress payments based on invoiced amounts even though the bid, which was the basis for the invoiced amount, was lost. Making payments based on invoiced amounts, which agree with the bid amounts, is a standard industry practice. Copies of contracts are essential in case of contract disputes.

Organization, Oversight and Supervision

Files Were Missing: OECD did not create files for 11 of 61 homeowners who applied for rehabilitation assistance in 1998. Furthermore, the rehabilitation specialists could not locate files for an additional five homeowners. Hence, OECD could not document: whether these applicants were assisted; what assistance was offered; and what assistance, if any, was provided.

Files Were Disorganized: Rehabilitation specialists did not maintain their files in a professional manner. Multiple copies of documents were contained in the same files and were not organized in an orderly fashion. Furthermore, one rehabilitation specialist did not file his completed projects with the other specialists' completed files. Although CPD noted the files were disorganized in their August 2000 monitoring report, we noted no improvement in the condition of the files when we began our review of the five properties in January 2001.

Files Did Not Contain Evidence of Supervisory Review: Although an Assistant OECD Director was responsible for supervising the rehabilitation program and one specialist was designated as the lead rehabilitation specialist, the files contained no evidence of supervisory review. Discussions with OECD staff confirmed there were no supervisory reviews of the files. The City's rehabilitation procedures also did not provide for quality assurance checks to be performed at specific milestones to ensure the files were complete, adequately documented, logically organized, and appropriate actions taken.

Position Descriptions Were Inaccurate: The position description for one of the OECD Assistant Directors tasked the individual with the responsibility for supervising the rehabilitation program but the individual did not supervise the program. Instead, the other OECD Assistant Director supervised the program although there was no mention of that responsibility in the individual's position description. General business practices require position descriptions to accurately reflect employees' duties.

Productivity Not Measured and Staff Was Not Provided Feedback On Performance: The OECD Director could not provide basic management information relating to the productivity of the rehabilitation specialists. Also, OECD staff did not compile reports to measure productivity and there was no management information system available to provide the needed information. In addition, supervisors did not establish productivity goals for employees and communicate them to employees. Furthermore, supervisors did

not perform periodic appraisals of employees' performance. General business practices require measuring employees' performance, establishing and communicating goals to employees, and providing employees feedback in the form of periodic performance appraisals to employees.

Waiting List Was Poorly Designed: OECD's waiting list for administering its OOSF rehabilitation program was poorly designed and did not provide useful information. For example, the list did not always indicate: the name of the specialist assigned to work the project; the date the specialist began working the project; and the final disposition date of the project. OECD did not have any other report, which provided the same information. As a result, we could not independently determine which applicants were processed, which projects were completed, and which applicants were waiting to be processed. OECD personnel could not make the same determinations without discussion among themselves.

Waiting List Was Not Controlled: We reviewed the waiting list and made the following observations: applicants were crossed off the list without explanation; a project number was assigned, yet the data fields for the applicant's name, address, and phone number were blank; it appeared as though an entry for an applicant was inserted between existing entries on the list; and, there was a discrepancy between the waiting list and the project file data. In addition, we found the City assisted a homeowner who was not on the waiting list. These conditions indicate a lack of control over the waiting list and the processing of applicants into the program. We discussed our concerns about the waiting list with the OECD Director during the audit. The Director informed us the staff recently developed an automated waiting list. We examined the automated waiting list and found it too did not provide all of the information needed to manage the rehabilitation program.

Procedures Not Maintained: We also noted instances where the City's rehabilitation procedures were out-of-date. For example:

- The City's HOME procedures require the use of joint escrow accounts for paying contractors. These accounts are not used and the city pays the contractors directly using HOME funds.
- HOME and CDBG procedures referred to an employee position that no longer existed due to reorganizations within OECD.
- CDBG and HOME procedures referenced building codes that the City no longer used.

City Taking Action

The OECD Director agreed to prepare cost estimates and attempt to obtain at least two responsive bids from contractors bidding on rehabilitation projects. However, City officials did not yet approve these procedures. The OECD Director also said he:

- was developing a checklist to assist the rehabilitation specialists to organize their files;
- was developing an automated waiting list that would provide useful information;
- ordered his staff to begin organizing the rehabilitation files; and
- had the contractor fix siding and insulation at one property we inspected.

Summary

The City needs to improve its supervision and oversight of the rehabilitation program. The City needs to: establish quality assurance procedures; develop and compile basic management reports to measure productivity; establish productivity goals and communicate these goals to employees; monitor employees work; and provide feedback to employees of their performance in meeting these goals.

At the Exit Conference, City officials informed us the code violations identified during our physical inspections of rehabilitated properties were abated. Accordingly, until CPD verifies that the repairs were made, these costs are considered questionable.

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Business Loan Guarantee

Background

In June 1996, a local start-up company requested assistance from the City to finance start-up costs for their business, which planned to create jobs for low and moderate-income persons. The company requested the City guarantee an \$800,000 bank loan with CDBG funds. The company planned to use the loan proceeds to purchase industrial equipment to manufacture a unique composite building panel system for the construction industry. The City agreed to guarantee the loan and a local bank loaned the company \$800,000 in December 1996.

By the end of 1998, the company defaulted on the loan and subsequently went out of business. The City began making payments on the loan starting in January 1999. As of February 2000, the City paid \$480,000 on the loan. CPD advised the City not to make any further payments against this activity, based on the results of their monitoring review. The City complied and ceased making payments.

Criteria

24 CFR 570.209(a) states HUD has developed guidelines designed to provide the recipient with a framework for financially underwriting and selecting CDBG-assisted economic development projects, which are financially viable and will make the most effective use of the CDBG funds. These guidelines, also referred to as the underwriting guidelines, are published as Appendix A to the regulation. The use of the underwriting guidelines published by HUD is not mandatory. However, grantees electing not to use these guidelines would be expected to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business.

24 CFR 570.506 requires recipients to establish and maintain sufficient records to document whether the recipient has met program requirements.

24 CFR 570.506(b)(5)(ii)(A) provides where the recipient chooses to document that at least 51 percent of the jobs will be held by low and moderate-income persons, documentation for each assisted business shall include a copy of a written agreement containing:

- a listing by job title of the permanent jobs to be created, identifying which are part-time, if any; and
- a listing by job title of the permanent jobs filled.

OMB Circular A-87 Attachment A (C)(1)(a) provides, to be allowable under Federal awards, costs must be necessary and reasonable for proper and efficient performance and administration of the awards. Attachment A (C)(2)(d) provides in determining reasonableness of a given cost, consideration shall be given to whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government.

Results

Proper Underwriting Was Not Conducted: Although 24 CFR 570.209(a) did not require the City to use HUD's published underwriting guidelines, the City was required to conduct basic financial underwriting. However, the City did not perform any underwriting for this activity. Although the City had copies of the company's business plans and pro formas in its files, there was no evidence the documents were reviewed critically to ascertain the true viability of the venture. Also, in its September 2000 response to CPD's monitoring review, the City stated it decided to leave the final underwriting to the bank because the project was large and complicated. The City's decision to leave the underwriting function to the bank was questionable because the bank's interest was protected by the City's obligation to cover the loan in the case of default. Therefore, the bank was not an objective third party acting in the City's best interest.

Representatives of the company and the former Mayor of Williamsport solicited the Commonwealth of Pennsylvania to provide grants and low interest loans. The Commonwealth agreed to provide up to \$3 million in assistance if the company could raise \$7 million in equity. The Commonwealth eventually provided no assistance because the company did not raise the needed equity. Despite the company's inability to secure assistance from the Commonwealth, the City proceeded with its plans to assist the company.

The City's failure to perform an underwriting analysis of the loan resulted in a 100 percent guarantee for an overpriced loan, for which other public funds could not be secured. Contrary to OMB A-87 Attachment A (C)(2)(d), the City's decision to proceed with a 100 percent pledge of CDBG funds subsequent to the company's failure to secure \$3 million of assistance from the Commonwealth, without a thorough evaluation of the project's feasibility, was irresponsible; especially in light of the fact the interest rate on the loan was two percentage points higher than the prime rate at the time (10.25 percent vs. 8.25 percent). If the prime rate is the cost of money on low-risk loans to the most stable and creditworthy customers, then logic dictates the interest rate charged for a no-risk loan should be less than the prime rate.

Job Creation Documentation Was Not Maintained: 24 CFR 570.506 requires all grantees qualifying an activity based on job creation, to provide a listing, by job title, of the permanent jobs to be created. In addition, the City's Economic Development procedures require a listing of all permanent jobs to be created which include job title, salary range, duties and responsibilities, and required experience and/or educational background.

The City did not maintain job documentation as required. We found only one document in OECD's files addressing the number of jobs to be created. That document was the company's letter to the City seeking financial assistance. In the letter, the company estimated: the initial phase of their project would result in 30 new jobs and low and moderate-income persons would occupy 16 of them; later, a total of over 100 jobs would be created in the company's existing facility, of which low and moderate-income persons would occupy 30 of them; and 200 more

jobs would be created when the company opened its new facility. We found no evidence the City requested the company to provide the required job creation information.

Furthermore, we found evidence low and moderate-income persons were not likely to get any of the jobs created. In a June 1996 City Council meeting, a representative from the company stated the jobs to be created would be highly technical; the jobs would be occupied by persons with higher educations, who were very highly competent at computers and had technical skills to operate machinery. There was no discussion about how low and moderate-income workers fit into the company's plans.

In its 1997 performance report, the City reported the company provided jobs to five low and moderate-income persons. Documentation maintained in the City's files showed the company hired 12 employees between June 1995 and March 1998, and 5 of the 12 were from low and moderate-income households. However, the City approved the loan guarantee based on the company's plan to hire 16 low and moderate-income persons in the initial phase of the project. Since only 5 of 12 jobs (42 percent) were held by low and moderate-income persons, the activity did not meet the national program objective of benefiting low and moderate-income persons, because the number of jobs held by low and moderate-income persons was less than 51 percent.

In August 2001, the City informed us its Special Counsel performed an analysis of the public benefit requirements for this economic development activity. Counsel asserted the business was in a neighborhood with a poverty level qualifying the activity under a presumed job creation benefit to low and moderate-income persons, and since this is a statutory presumption, it is an absolute presumption for national objective purposes. We verified that this provision was incorporated into the HUD regulations at 24 CFR 570.208 (a)(4)(v). However, the City did not provide documentation to support the poverty level for the neighborhood where the business was located. We also noted that the City did not identify the presumed benefit criteria in its 1997, 1998, and 1999 annual plans and performance reports.

Loan Proceeds Were Used for Other Purposes: On all its reports to HUD, the City indicated the proceeds from the bank loan would be used to purchase industrial equipment. The community at large was led to believe the proceeds would be used to purchase industrial equipment as well. For example, in a November 1996 City Council meeting, a member of Council asked for clarification as to why the Surety Agreement did not explain the funds were to be used to purchase equipment. The Mayor assured the Council member the loan was to be used to purchase equipment. However, we found only \$450,000 of the \$800,000 loan proceeds were used to purchase equipment and \$316,673 were used for other purposes.

Since OECD had no documentation in its files to show how the loan funds were spent, other than a \$430,000 bill-of-sale for the purchase of equipment, we requested copies of all the cancelled checks and other documentation from the bank. We sorted the information by category from copies of the loan checks by payee. The bank did not have any documentation supporting the loan checks; therefore, we could make no further determination on what the payments represented. The following table shows how the loan proceeds were spent.

Payments by Category	Total Payments
Equipment	\$450,000
Past Due Creditors	200,301
Fees to Attorneys, Bank, Consultants	96,984
Interest Payments on the Loan	<u>19,388</u>
Total	\$766,673
Loan Amount	<u>800,000</u>
Remaining Balance of Funds	<u>\$ 33,327</u>

The \$200,301 used to pay creditors could have been for this project/activity or for any other project/activity in which the owners were involved. The items included payment: of past due rent, \$31,425; for temporary service employees, \$15,804; to hotels and restaurants, \$6,126; for cell and telephone service, \$5,079; for office supplies, \$2,476; dairy equipment and supplies, \$445; surgical companies, \$207; etc.

We found documentation in both the City's files and the bank's files indicating some City managers were aware that part of the loan proceeds would be used for purposes other than purchasing equipment.

Contrary to the requirements of 24 CFR 85.20(b)(3), there was no indication the City reviewed the payments to the creditors to determine if the costs were legitimately attributable to the company's business; moreover, contrary to OMB Circular A-87, there was no indication of any action to determine if the payments were prudent, considering the company's circumstances.

Procedures Need Revision: The City's policies and procedures for Economic Development activities need revision. Although the procedures include excerpts from HUD regulations, a checklist for obtaining documentation to demonstrate compliance with HUD regulations, and copies of various forms to be completed, the procedures do not identify the employee responsible for obtaining, reviewing, and/or approving the required documentation.

Files Were Disorganized: OECD did not maintain the files for this activity in a professional manner. OECD had copies of business plans, feasibility studies, and various correspondences between the City, the company, banks, various law firms, and the Commonwealth of Pennsylvania, but the documents were not organized in an orderly fashion. Because the files were disorganized, documents could not be readily located, or located at all, this condition unnecessarily delayed the audit.

Summary

From our review, we concluded the City's expenditure of \$480,000 was ineligible for this activity. Although the City's Special Counsel identified a presumed public benefit justification for the project in August 2001, the City, contrary to HUD regulations, did not perform basic underwriting to support the loan guarantee or review outstanding creditor invoices to determine if the costs were legitimately attributable to the company's business.

Homebuyer Assistance

Background

In 1995, the City of Williamsport and a private developer entered into a HOME Opportunities Partnership Agreement. The goal of this public-private partnership was to use HOME funds to increase homeownership opportunities for low-income households. The agreement called for the City to provide a maximum of \$32,000 of HOME funds per unit. Between 1996 and 2001, the City provided a total of \$1,189,523 directly to the developer for lot acquisition and construction costs associated with 40 single-family units to be constructed at a development known as West End Terraces (WET) for low-income homebuyers. At closing, the homebuyers assumed a soft second mortgage¹ of up to \$32,000.

As of April 2001, 28 of the 40 units were constructed and occupied.

Results

24 CFR 92.508 requires grantees to establish and maintain sufficient records to document whether the grantee has met program requirements. We found the City did not maintain documentation to demonstrate compliance with requirements. Specifically, the City could not demonstrate HOME funds invested in the WET activity were used efficiently and met program requirements. Our audit disclosed the City did not:

- document the necessity of the HOME investment;
- ensure project costs were reasonable;
- ensure only qualified low-income families were assisted; and
- ensure Davis-Bacon requirements were followed.

Upfront Evaluation Not Documented: HOME regulation 24 CFR 92.250(b) requires a grantee to evaluate HOME funded projects to ensure HOME investment is not more than is necessary to provide affordable housing. HUD guidelines found in CPD Notice 94-24 (IV): Layering Guidance, provide this review be documented and the documentation should be included in the project file. The OECD's Director claimed an evaluation was performed. However, the Director was unable to provide a copy of the evaluation. Also, the OECD's files did not contain evidence any such evaluation had been performed. As a result, the eligibility of HOME funds totaling \$1,189,523 is in question since the City could not demonstrate that no more funds than were necessary to provide affordable housing were invested in this project.

24 CFR 92.505(a) requires the City to follow OMB Circular A-87 when determining costs for awards carried out by the HOME Program. OMB A-87, Attachment A (C)(1)(a), provides for costs to be allowable they must be reasonable. A reasonable cost is defined as a cost that in its

¹ Soft second mortgage is a mortgage with unconventional interest rates and repayment terms. These soft second mortgages were interest free and required no repayment until after the last primary mortgage payment was made as long as the buyer occupied the HOME-assisted unit. At that point in time, the buyer is required to repay 50 percent of the HOME funded mortgage to the City.

nature and amount does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs.

At the inception of this program, the City (grantee) had a responsibility to ensure HOME investment was not more than was necessary to provide affordable housing. We asked the City for a copy of its evaluation or any other documents evidencing how the City determined the amount of HOME funds were necessary to provide affordable housing. As of the date of the Exit Conference, the City did not provide any documentation such as cost estimates of the property and structure or an analysis of how a low-income person was going to obtain financing to afford a \$100,000 home. The City also did not provide any documents evidencing they performed an analysis upon which to make their decision that the amount of HOME funds being invested was reasonable and the price of the property was affordable.

We were advised, after receiving our finding, the City had its Consultant perform an analysis of the project. At the Exit Conference, the Consultant provided mortgage-financing documentation including two appraisals, a settlement sheet and two letters from Federal Home Loan Bank of Pittsburgh (FHLB). Along with these documents, the Consultant provided an explanation of how the mortgage was financed.

The two appraisal reports for one property (an appraisal of the proposed property dated July 22, 1997, and an as built appraisal dated May 10, 1999) were provided to demonstrate appraisals were obtained to support the land and structure value of the property. However, after discussing these reports with the appraiser, we concluded the reports were prepared for mortgage purposes. Further, they did not represent appraisals to establish the value of the land at the time of sale to the City or the value of the land based on a cost approach.

The Consultant and others stated they had concerns over the viability of this project at the outset. However, after reviewing the project six years later, the Consultant concluded the project is a success. With regard to the financing of a \$100,000 property, the Consultant stated low income homebuyers obtained the maximum mortgages they could afford from Pennsylvania Housing Finance Agency (PHFA), an interest free second mortgage of up to \$25,000 from FHLB², and an interest free third mortgage of up to \$32,000 from City's HOME Program. As an example, the Consultant provided an August 2001 settlement sheet showing a buyer purchased a \$100,000 property, and received \$46,500 from PHFA, \$25,000 from FHLB, and \$32,000 from the City's HOME Program for a total mortgage commitment of \$103,500.

We analyzed the documentation provided at the Exit Conference and a spreadsheet previously provided by the City showing each homebuyer's mortgages. We found PHFA provided first mortgages ranging from \$45,200 to \$73,000. The majority of the low-income homebuyers received \$3,000 of FHLB funds and two received \$25,000. The City provided the maximum \$32,000 of HOME funds to 24 of 28 homebuyers.

For the three homebuyers we found to be qualified as low-income persons, their incomes ranged from \$16,300 to \$18,200. The three homebuyers obtained mortgage financing as follows:

² FHLB provided a total of \$428,000 for this project, initially providing \$48,000 for closing cost assistance for 16 units. In May 2000, FHLB provided the remaining \$380,000.

Buyer	Primary Mortgage PHFA	Private Mortgage	FHLB Mortgage	HOME Funds	Total Mortgage*
1	\$-0-	\$39,500	\$-0-	\$32,000	\$71,500***
2	\$45,200	\$-0-	\$25,000	\$32,000	\$102,200
3	\$47,500	\$-0-	\$3,000	\$32,000	\$82,500**

* = The \$32,000 HOME mortgage is interest free and requires no repayment until after the last primary mortgage payment. The buyer is required to repay 50 percent of the HOME mortgage amount.

** = The total mortgage was reduced by \$13,115 because the homebuyer received private funds for this transaction.

*** = The total mortgage was reduced by \$30,761 because the homebuyer received an inheritance. The developer provided the homebuyer's mortgage.

Based upon these three homebuyer's incomes, we have concerns about how these low-income persons are able to afford these homes since no upfront evaluation was made. Consequently, we have no assurance these HOME-assisted units have benefited the low-income persons Congress intended. As a result, we believe CPD needs to perform an analysis to determine the viability of this project.

The City Did Not Accurately Determine Homebuyer's Eligibility: The OECD Lead Rehabilitation Specialist was responsible for performing applicant income eligibility determinations. We asked the specialist to identify the definition of annual income the City decided to use to determine the income eligibility of prospective homebuyers. 24 CFR 92.203(a) requires grantees to determine whether a family is income eligible by determining the family's annual income. 24 CFR 92.203(b) provides when determining whether a family is income eligible, grantees must use one of three definitions of annual income. It was only after consulting with an OECD Assistant Director that the specialist was able to inform us the City uses definition number one of annual income, as defined at 24 CFR 5.609. Under 24 CFR 5.609, annual income means all amounts, which are anticipated to be received.

OECD did not have written procedures for determining income eligibility. Therefore, the method of determining income eligibility was susceptible to manipulation. The HOME regulations do not require specific procedures be used to determine an applicant's income. However, it would be beneficial for the City to create written procedures and implement a consistent methodology that provides sufficient information to accurately determine income eligibility. HUD's Technical Guide for Determining Income and Allowances for the HOME Program could be used as a guide for developing the income eligibility procedures.

Currently, the OECD specialist obtains income eligibility data from employer income verification forms and, in some cases, recent pay stubs. We found the specialist did not consistently consider current and historical earnings reported on the verification forms. The specialist did not always consider all family member's income, anticipated pay raises, and historical bonuses, commissions, and overtime earnings when making their eligibility determinations. We considered the employer reported earnings information for the six families

Appendix E

we reviewed and determined three of the six families assisted were actually not eligible for assistance.

The following example illustrates how the amount of eligible income can be manipulated without standard procedures. The OECD specialist used the year-to-date figures (two months) from the employment verification form and extrapolated an annual amount for base wages, commissions, and overtime. The specialist considered the reported bonus amount. Although the reported bonus was \$600, the specialist used \$500 in the calculation. The specialist's methodology overestimated anticipated commissions and underestimated overtime, bonuses, and the spouses anticipated base wages.

We used the reported historical data from years 1997 and 1998 to calculate the commissions, bonuses, and overtime pay because it was logical to anticipate the employee would receive similar amounts in the coming year. The employer made no notations on the form to indicate this would not be the case. Therefore, we determined the commission, bonus, and overtime pay amounts by taking the average of the compensation reported for those years. For base wages of both spouses, we multiplied the current hourly rate of pay, times the average number of hours worked per week, times 52 weeks to determine the amount.

Earnings Reported on Employment Verification Form:

Income Source	Year-to-Date as of 2/6/1999	1998	1997
Base Wages	\$ 1,960.52	\$ 15,686.07	\$ 15,015.75
Commissions	210.85	1,773.26	1,091.37
Bonus	600.00	1,840.20	1,663.52
Over Time	<u>122.27</u>	<u>4,605.58</u>	<u>4,606.09</u>
Total	<u>\$ 2,893.64</u>	<u>\$ 23,905.11</u>	<u>\$ 22,376.73</u>

Income Calculations:

Income Source	Specialist's Calculation	Auditor's Calculation
Base Wages	\$16,991.00 ¹	\$16,952.00 ⁴
Commissions	1,827.28 ¹	1,432.32 ³
Bonus	500.00 ²	1,751.86 ³
Over Time	<u>1,059.76</u> ¹	<u>4,605.84</u> ³
Total	\$20,378.04	\$ 24,742.02
Spouse Income	<u>9,848.28</u> ¹	<u>10,920.00</u> ⁴
Grand Total	\$ 30,226.32	\$ 35,662.02
Income Limit	<u>34,800.00</u>	<u>34,800.00</u>
Difference	<u>\$ (4,573.68)</u>	<u>\$ 862.02</u>

¹ = OECD used 2 month, year-to-date amounts and extrapolated to annualize.

² = OECD used \$500 rather than reported \$600.

³ = Computed based on average reported for last two years.

⁴ = Computed based on current hourly rate of pay multiplied by average number of hours worked per week multiplied by 52 weeks.

After considering all of the earnings information, we determined the homebuyer's income was over the income limit, and therefore, ineligible to receive assistance.

Also, contrary to 24 CFR 92.203(d)(2), the specialist failed to re-calculate income eligibility determinations for two homebuyers. In those instances, more than six months elapsed between the time the homebuyer initially qualified for assistance and the time the assistance was provided.

Davis-Bacon Requirements Were Not Followed: Contrary to 24 CFR 92.354(a)(1), the City did not ensure the developer paid workers the prevailing local wage pursuant to the Davis-Bacon Act. The regulation requires any contract for construction of housing with 12 or more HOME assisted units must contain Davis-Bacon wage provisions. Arranging multiple construction contracts within a single project for the purpose of avoiding the wage provisions is not permitted.

We found the City and the developer entered into five separate agreements to fund the acquisition and construction of 40 HOME-assisted units at WET. Each agreement was for less than 12 lots. In addition, there was a separate construction contract for each new home. However, neither the agreements nor the contracts addressed Davis-Bacon requirements. We believe the City and the developer structured the contracts this way to circumvent Davis-Bacon requirements. To illustrate, we noted the last 14 lots were purchased in a single transaction. However, the City executed two separate agreements on the same date, for six and eight lots, respectively.

Both the City and the developer denied the project was structured to circumvent Davis-Bacon requirements. The OECD Director said the Davis-Bacon provisions were not required because the contracts, funding years, and funding sources for each agreement were different. Both the developer and the OECD Director indicated Davis-Bacon was not required because each agreement provided no further commitment by the City to provide additional HOME funds. Further, the developer indicated workers were already being paid wages higher than those required by Davis-Bacon; although the developer provided no documentation to support that statement.

At the Exit Conference, the City stated it did not attempt to avoid Davis-Bacon requirements; contracts could only be provided based on annual allocation of funds; and the initial agreement made it clear the City could not commit to dollars in advance of their receipt. Also, the developer's financing with the bank, limited the number of units that could be developed at any one time. In addition, the City stated this project, in light of the way it was financed, is not subject to Davis Bacon requirements and provided an August 1996 Labor Relations Letter, Letter No. LR-96-02, as support.

We reviewed LR-96-02 which included case studies regarding the application of the Davis-Bacon labor standards to HOME projects. Specifically, Section II Unit Threshold states:

The Davis-Bacon "trigger" relates to the number of HOME-assisted units contained in a construction contract. The two factors to be considered are the number of HOME units and the scope of the construction contract. The

participating jurisdiction determines the number of assisted units in a project, not a construction contract.

The City and the Developer executed a Home Opportunities Partnership Agreement indicating the City would provide a total of \$1.4 million of HOME funds from its FY 1994 through FY 1999 HOME Program allocation, provided the allocation was received by the City for the designated years. Per the agreement, each year, for a period of five years, the City would provide HOME funding to the developer to develop and assist the largest number of eligible households by constructing affordable housing units. Also, per the agreement, HOME Program assistance would not exceed \$32,000 per unit. Based upon the total amount of HOME funds specified in this agreement and the maximum assistance limit per unit, we believe the initial scope of this project was about 43 units. Further, minutes from a City Council meeting indicated 80 single-family homes (of which about 43 would be HOME-assisted) were planned for WET over a period of six years. Therefore, we believe Davis-Bacon provisions applied because as long as the City received the HOME funds allocation, the City intended to fund about 43 HOME-assisted units.

We also believe if financing limited contracts to be less than 12 units at a time was the reason not to include all units under a single contract, the developer would not have executed two contracts on the same day for a total of 14 units.

We recommended CPD refer this project to the Department of Labor for an opinion on whether Davis-Bacon applied to this HOME project.

Activity Not Adequately Monitored: 24 CFR 85.40 makes grantees responsible for monitoring their supported activities to ensure funds are used in accordance with applicable Federal requirements. We found the City did not adequately monitor this activity. We reviewed the activity files and found no evidence monitoring for compliance with Federal laws and HUD regulations occurred. We asked the OECD Director whether staff monitored this activity and to provide documentation to demonstrate monitoring occurred. The Director provided no documentation and claimed previous site inspections, meetings, and phone conversations constituted monitoring. However, the inspections, meetings, and phone conversations were not adequate to ensure acquisition and construction costs were reasonable, and document the amount of HOME funds invested was not more than was necessary to provide affordable housing.

Summary:

From our review, we concluded the City's expenditure of \$1,189,523 was ineligible for this activity. Contrary to HUD regulations the City did not: document the necessity of the amount of its HOME funds invested in this activity; ensure project costs were reasonable; employ the provisions of the Davis-Bacon Act to assure worker's are paid the prevailing wages for the area; and, assist only qualified participants.

Blight Elimination

Background

In 1998, the City loaned \$350,000 of CDBG funds to a for-profit development corporation to acquire and clear a blighted factory complex and construct market-rate housing on the cleared property. The loan was for 30 years with a simple interest rate of two percent. The agreement deferred principal and interest payments to years 20 through 30.

Criteria

24 CFR 570.200(a)(2) states funded activities must meet at least one of the CDBG Program's national objectives.

24 CFR 570.203(b) allows grantees to assist private, for-profit businesses with CDBG funds to carry out economic development projects.

24 CFR 570.208 (d)(1) states when property is acquired for the purpose of clearance to eliminate specific conditions of blight, the clearance activity shall be considered the actual use of the property. However, any subsequent use of the cleared property shall be treated as a "change of use" under 24 CFR 570.505.

24 CFR 570.505 (a) & (b) states a recipient may not change the use or planned use of any property acquired with CDBG funds unless either:

- the new use qualifies as meeting one of the national objectives; or,
- if the grantee determines, after consultation with affected citizens, it is appropriate to change the use of the property to a use which does not qualify as meeting one of the national objectives, it may retain or dispose of the property for the changed use if the CDBG Program is reimbursed the current fair-market value of the property.

24 CFR 91.505 states grantees shall amend approved plans whenever there are changes in the purpose, scope or beneficiaries of an activity. It further states substantial plan amendments are subject to a citizen participation process. It also requires the grantee to make the amendment public and notify HUD of the change.

OMB Circular A-87 provides principles for determining allowable costs for Federal awards. The Circular, at Attachment A (A)(2)(a)(2), states governmental units are responsible for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award.

Results

Activity did not meet national program objectives: In 1998, the City loaned CDBG funds totaling \$350,000 to a for-profit development corporation to acquire and demolish an abandoned, blighted factory complex. The City's files contained photographs and copies of code violations demonstrating the blighted condition of the complex. The City's records also contained evidence City officials were aware plans included the construction of market-rate housing on the cleared property. For example, at a June 1998 Finance Committee Meeting, a City Official stated this project was turned down by the Pennsylvania State Department of Community and Economic Development for financing because it did not pertain to housing for low and moderate-income persons, which is a high priority of the State. Further, we contacted the Property Manager of the newly constructed housing complex to determine if this project was benefiting low and moderate-income persons. The Property Manager indicated this development was all market rate housing and no verification was performed to determine low and moderate-income eligibility. We obtained the rental rates from the Property Manager. Our review disclosed both the proposed rents and actual rents charged for the units far exceeded established Fair Market Rent (FMR) limits as illustrated in the following table:

	Unit Size	
	1 Bedroom	2 Bedroom
1998 Proposed Rent	\$545	\$680
1998 Fair Market Rent	\$360	\$433
Actual Rent 1999-2001	\$610	\$590-\$685
1999 Fair Market Rent	\$366	\$441
2000 Fair Market Rent	\$369	\$444
2001 Fair Market Rent	\$373	\$448

As a result, we concluded this housing was not affordable to low and moderate-income persons. The OECD Director said he relied on the advice of the City's consulting firm that the cleared property could be used for any purpose after the spot slum and blight national objective was met. However, the Director could not provide any documentation to support that claim. Documentation subsequently provided by the consulting firm, contradicted the Director's claim. In fact, the documentation provided by the consulting firm identified new housing construction as an option for the cleared property, but it would qualify only if low and moderate-income persons occupied the new housing. Therefore, contrary to HUD regulations and the principles of OMB Circular A-87, this activity did not meet national program objectives because the housing constructed on the cleared property did not benefit low and moderate-income persons.

The City solicited guidance from HUD's General Counsel in October 2001 regarding the reimbursement requirement of 24 CFR 570.505. The City sought an opinion as to whether repayment of the loan principle (20 years into the future) could constitute reimbursement to the CDBG Program. Although Counsel rendered no opinion as of January 28, 2002, we believe repayment of the loan does not constitute reimbursement to the program. By waiting years for its CDBG Program to be reimbursed, the City will forgo the opportunity to assist eligible low and moderate-income persons for whom the CDBG Program was designed. Further, the City would

have had to consult with the affected citizens before loaning the funds and document the fair market value of the property at that time.

Activity was not eligible for funding: Contrary to HUD regulations and OMB A-87, the City provided funds to a for-profit entity for residential construction. A for-profit entity can only receive CDBG funds to carry out an economic development project, which this activity is not. There is no provision in the CDBG regulations that permits funds to be provided to a for-profit entity for residential construction. Thus, even if the ultimate reuse of the property met a national objective, the manner in which the CDBG funds were used made this activity ineligible. Even if the City or a non-profit entity acquired the property, HUD regulations require the subsequent use of a property acquired and cleared with CDBG funds to meet a national program objective. Since the housing constructed was market-rate and did not benefit low and moderate-income persons, the funds would be ineligible in any case.

Subsequent use of the property was not disclosed: In their 1998 annual plan, the City informed HUD and their citizens, CDBG funds for this activity would be used to demolish and clear an abandoned blighted factory complex. The City reported the complex was demolished and cleared in its 1998 and 1999 performance reports. However, neither the plan nor the reports disclosed the subsequent use of the property for market-rate housing. In addition, there was no other documentation (copies of letters, faxes, e-mails, etc.) in either the City's files or HUD's to demonstrate disclosure to HUD. The OECD Director believed no further reporting was required because the cleared property could be used for any purpose after the spot slum and blight national objective was met.

HUD regulations require plans submitted by recipients include a description of each activity to be undertaken and citizens be involved in the process of developing the plan. Regulations also require HUD and the citizenry to be informed whenever there are changes in the purpose or scope of an activity, or when an activity not previously described in the action plan is carried out. However, contrary to HUD regulations and the principles of OMB Circular A-87, the City did not disclose the details of this activity to HUD and its citizens, although the subsequent use of this property for market-rate housing constituted a substantial change to the activity, as reported. Thus, the City should have disclosed the property's change of use and given its citizens an opportunity to comment on the changed use of the property as required.

Summary

From our review, we concluded the City's expenditure of \$350,000 ineligible for this activity. Contrary to HUD regulations and the principles of OMB A-87, the City loaned CDBG funds to a for-profit entity for housing construction and the subsequent use of the cleared property did not meet a national CDBG Program objective.

At the Exit Conference, the City's Consultant asserted that this project meets the national program objective of benefiting low and moderate-income persons. The consultant stated OECD personnel conducted a survey of the occupants, since we completed our on-site fieldwork, and determined 32 tenants, occupying 56 percent of the new housing units constructed, were low and

moderate-income persons. However, neither the consultant nor OECD personnel provided any documentation, such as the survey or income verifications, to support that assertion. Furthermore, even if the City eventually provides documentation evidencing low and moderate-income persons benefited, the \$350,000 is still ineligible because the City loaned CDBG funds to a for-profit entity for housing construction.

Schedule of Questioned Costs

Recommendation Number	Type of Questioned Costs	
	<u>Ineligible</u> ¹	<u>Unsupported</u> ²
1D	\$ 2,060,594	
1E		\$ 394,735
1F		165,000
1A		16,455 (1)
(2)	1,586	
	<hr/>	<hr/>
Total	<u>\$ 2,062,180</u>	<u>\$ 576,190</u>

(1) Rehabilitation cost considered questioned until correction verified by CPD.

(2) Reimbursed to the program per letter dated 10/2/01.

¹ **Ineligible costs** are those costs that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds.

² **Unsupported costs** are those costs whose eligibility cannot be determined at the time of the audit since such costs were not supported by adequate documentation.

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Auditee Comments



CITY OF WILLIAMSPORT
CITY HALL
245 West Fourth Street
Williamsport, Pennsylvania 17701

February 11, 2002

Mr. Daniel G. Temme
District Inspector General for Audit
U.S. Department of Housing and Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

Dear Mr. Temme:

I want to thank you and your staff for the time and effort that has been taken to identify the problems and concerns in our internal control structure that will enable us to improve our administration of the CDBG and HOME Programs. When I took office in November 2000, the audit was just underway. I have conferred continuously with my OECD Director about the problems and concerns he and the auditors have identified. We took action needed to retain a Special Counsel experienced in the operation of these federal programs to assist us in making our administration of these programs efficient and effective.

The Director, working with the information provided by the auditors, the Special Counsel, and from those other matters he has identified, has taken measures to improve internal controls, policies and procedures. Improvements in monitoring and file maintenance are now in place. We early on started to address needed increases in staff training that were raised and intend to pursue additional opportunities provided by HUD and national and regional peer groups. The City also is in the process of attempting to add an additional staff person to the OECD office who has some experience with these HUD programs. We have been providing extensive supportive documentation of those drawdowns of funds under these two programs that are required to carry out the various activities supported by the grants.

The Director, assisted by our Special Counsel and our Consultant, has been submitting additional documentation to your auditors in response to various issues raised that has been obtained to supplement the information provided earlier. We have also been

developing alternatives to the interpretations of the program regulations identified by the auditors as well as providing explanations and relevant considerations to your office that we feel will ultimately reduce substantially the amount of funds that the audit report states requires more documentation or support for the costs to be determined eligible.

In the end, we expect that administration of our programs will be significantly improved as a result of all our collective efforts, that our staff will have become quite proficient in applicable program requirements, and that we will be able to sustain fully the eligibility of the funds that have been expended.

We are providing you by separate cover the completed response of the City to the Draft Audit Report provided us on January 30, 2002, so you may consider it fully in developing your final Report on your audit.

I again want to convey my appreciation to you for the courtesy you have extended in this matter and for the efforts that have been expended to ensure a relatively balanced review of the issues raised by your auditors. I cannot say that the experience has been enjoyable, since a great deal of extra work has been required of much of the City staff as well as our OECD office. However, we do believe it has been constructive and that we will perform much more efficiently and effectively in the future as a result of this process of review.

Sincerely,


Mayor

OTTO J. HETZEL, ESQ.
ATTORNEY AT LAW

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February 12, 2002

Mr. Daniel G. Temme
District Inspector General for Audit
U.S. Department of Housing and Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380
Attention: George Datto

Dear Mr. Temme:

Enclosed please find one copy of the City of Williamsport's Response to your office's Draft Audit Report, dated January 29, 2002. We previously have provided you with a fax copy of the Response and also a copy as an attachment by email to you and George Datto of your staff. The Mayor previously sent you his cover letter for the Response.

Please let me know if you have any questions.

Sincerely


Otto J. Hetzel

Enclosure

**CITY OF WILLIAMSPORT,
PENNSYLVANIA**

**Community Development Block Grant Program
Home Investment Partnership Program**

RESPONSE TO

Draft Audit Report

Dated January 29, 2002

from the

U.S. Department of Housing and Urban Development

District Inspector General for Audit

Philadelphia, Pennsylvania

February 11, 2002

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RESPONSE TO MANAGEMENT CONTROL DEFICIENCIES

The City's response to issues raised in the Draft Audit Report, starting at p. 3 and extending through page 34, generally dealing with program compliance and general management controls.

I.G. contention:

The Draft Audit Report, starting in the Executive Summary on pgs. 3 and 4, Management Control Deficiencies, states City staff need to have more direct knowledge and experience in HUD programs, additional training and more supervision, and the City needs additional written policies, procedures and management rules, specifically regarding processing purchasing requests, traveling on official business, and time reporting. Other existing policies needed to be updated, along with rehab procedures, organizational charts, and position descriptions. The City's Financial Management System was not adequate, reflected by failure to detect an accounting error, issue IRS forms, control assets and support HOME drawdowns in a timely manner. Its record management system was inadequate as was monitoring of its federally funded activities.

City Response:

The City of Williamsport began operating under the Third Class City Optional Charter Law in 1972. This occurred by way of the voters in a municipal election approving a referendum as recommended by a Charter Commission appointed by the City Council. The most appealing aspect of this form of government is the mandated system of checks and balances. The law clearly requires an independent Treasurer responsible for depositing all funds in the appropriate accounts, and an independently elected Controller who is responsible for in-house auditing and specifically reviewing receipts and disbursements for appropriate handling.

Further, the law requires that all checks for various City accounts have dual signatures, and provides for the independent scrutiny by separate, elected officials after the Mayor and his staff have processed all disbursements in accordance with policy. This system provides an adequate internal control environment for the administration and management of the City's CDBG and HOME programs.

Although the system can provide an appropriate foundation, the auditors have demonstrated that there is room for improvement. For instance, as indicated at the Exit Conference, the City recognizes it could benefit from the suggestions and recommendations of the auditors. While a number of improvements

responding to the auditor's suggestions have already been made, the City has undertaken to carry out a review of its policies, procedures, and systems to ensure that it operates its programs in an efficient and effective manner. For instance, the OECD staff has greatly improved its record-keeping systems and documentation process of drawdowns by creating a standard file format for HOME and CDBG rehabilitation and single-family program files. The new changes will significantly improve file documentation.

As pointed out elsewhere, the current City administration and OECD Director and staff were not necessarily originally involved with the inception of most of the activities audited and, thus, were not always familiar with the details of some of the activities selected by the auditors for review. Because some of the documents requested by the auditors were archived, in a number of instances significant amounts of staff time were required to research information. Therefore, staff were not always able to provide immediate responses to questions and requests for documents. In addition, in some cases, file documents could not be readily located because several sets of files may apply. For instance, there may be general personnel files for individual staff, yet matters relating to competitive selection may be maintained in other files relating to a particular job opening rather than in the personnel file for the individual ultimately hired. The City is taking steps to coordinate these files and cross-reference such matters so that specific documents may be more easily located in the future when requested or required.

The City believes that generally it has implemented federal procurement regulations where and when required relating to purchases under these federal programs. Any differences with the auditors' observations on procurement procedures appear to lie only in the extent of detailed documentation that is required. In any event, the City has taken the suggestions of the auditors, will act upon them, and will build in enhanced documentation in the areas noted.

As stated in the Report, the City has established new monitoring procedures in response to a HUD CPD finding. The City already has started to implement these procedures as was noted in the Report.

Effects on CDBG and HOME Programs (p. 4 of the Report)

The Report concludes that because the City failed to develop and implement a sound internal control environment to implement its CDBG and HOME programs, the following occurred. The City's response to each of these conclusions is provided in bold.

- Five of the six activities did not meet program eligibility requirements and should not have been funded. **As noted elsewhere, the City's response to the individual activities will show that there are differences in interpretation of the applicable regulations between the City and the auditors that will need to be resolved. Improved documentation really underlies much of the auditors' concerns and the City will be improving its file documentation procedures.**
- Two of the six activities reviewed did not meet CDBG standards for benefitting low and moderate-income persons. **The City has elsewhere addressed such auditor concerns in various programs and activities in this response. Again, essentially these matters relate to the extent of file documentation on this issue. Additional documentation to supplement that provided earlier is being obtained by the City and supplied to HUD.**
- \$2,060,594 of ineligible expenditures, \$411,190 of unsupported expenditures, an unsupported drawdown of \$165,000 of HOME funds, and \$1,586 on ineligible expenditures for business lunches were identified. **These are the amounts related to the six activities referenced above. The City believes it will be able to demonstrate that the expenditures involved will ultimately be shown to have been eligible once differences of interpretation of applicable requirements are resolved and additional documentation is reviewed.**

The \$1,586 relating to lunches for which insufficient documentation was available has already been repaid by the City. With respect to the \$165,000 HOME drawdown, resolution of the problem required the assistance of HUD technical staff responsible for its IDIS computerized reporting system so that the City was unable by itself to provide the information requested at the time of the audit.

As a matter of background, HUD and its grantees nationwide continue to experience problems with use of the IDIS reporting system for the HOME program. Many of the technical problems which occur in using the IDIS system require technical assistance from highly trained HUD personnel responsible for the monitoring and upkeep of the IDIS system. Those persons need to be involved to fix these problems. Frequently, it takes considerable time to resolve problems because few persons have the necessary technical expertise.

The City had requested a number of months ago the needed assistance to correct information in the IDIS system relating to HOME drawdowns and had informed the auditors and the HUD CPD office, who have been participating as well in resolving this problem, that it has been working to resolve the documentation issue involved. Based on the Report's recommendation, the City will work to improve its system for documentation of drawdowns to avoid such problems in the future.

- The City did not fully disclose details about funded activities in its annual plans and did not report or accurately report its accomplishments for funded activities to HUD. **The City fully disclosed information as to how funds were spent on activities to the extent such information was required. In response to the auditors' concerns, however, the City will endeavor to ensure that these reports in the future will be as accurate as possible. As far as accurately reporting its accomplishments, the City acknowledges that because the reporting requirements of HUD are time-sensitive, sometimes errors in reporting are made. The City will work to make sure that information is accurately reported, but some human mistakes are still likely to occur because of the complex nature of these program requirements.**
- Assistance was provided to ineligible homebuyers. **The City elsewhere has addressed the auditors' concern on this issue and believes that its assistance was provided to eligible buyers and that the differing calculations by the auditors do not appear to be consistent with established HUD procedures set forth in HUD guidance that the City followed.**
- Dwellings were rehabilitated without correcting all code and safety violations. **The comments and conclusions about the condition of these properties were based on inspections carried out well after the work was completed and inspected by the City. In one case, the code issue involved an owner's subsequent changes to a property. The response to Appendix C provides detailed explanations of the circumstances that were also shared during the Exit Conference. In an effort to resolve these matters, however, the City has taken the steps necessary to have each of the code violations corrected without concern as to when they occurred.**

HUD Management Actions Taken (p. 4 of the Report)

A history of actions by the HUD CPD office is detailed in the Report. In reporting about the CPD monitoring review in 1994, while the Report notes that there was recommended corrective action to address four program deficiencies, it should have added that HUD's letter of September 6, 1994, also contains a statement detailing its monitoring of City rehab files, one of the main issues raised in the monitoring and audit reports, which notes that at that time: "Generally, the files were well-organized and relatively thorough." The CPD field office has responsibility for on-site monitoring of grant recipients and working with grant recipients to improve program operations. CPD contended in its 2000 monitoring report that "severe problems" were found in 1992 and that it found the same problems in 2000. But, the CPD office did not work with the City to develop a corrective action plan in 1992, and in the interim, no subsequent monitoring visits to the City took place. The City recognizes, however, that as a practical matter, a number of improvements can be made in its internal control system as recommended in the audit report and these actions will be taken so that it can more efficiently and effectively manage its programs.

Recommendations: (p. 5 of the Report, with the City's response in bold)

1. Continue submitting supporting documentation for funded activities. **The City has and will continue to submit documentation as specified in the September 2001 letter by the Assistant Secretary until it is informed otherwise.**
2. Establish a formal training program. **As stated during the Exit Conference, specialized training has been provided to City personnel, and the City will take advantage of ongoing training opportunities at HUD and by national and regional peer organizations.**
3. Develop and implement policies and procedures. **The City has taken steps to tighten up existing policies and procedures and will develop and update policies and procedures where applicable, being guided by the recommendations of the audit report.**
4. Revise existing policies and procedures. **See number 3.**
5. Fully implement monitoring procedures. **As previously stated, the City has already started to do this.**

6. Create an inventory control system in compliance with HUD regulations. **The City maintains a fixed asset list for a variety of purposes that is updated each year. The OECD Director will work with the appropriate individuals in the City to implement changes needed to conform fully to HUD requirements.**
7. Review and revise employee position descriptions. **The City will review the position descriptions and determine if additional modifications are needed. Current position descriptions contain language that allows for other duties as assigned.**
8. Establish performance standards for annual evaluation of OECD's staff. **As pointed out during the Exit Conference, staff size may reduce the need for detailed documentation of supervision; to improve its operations, evaluation procedures adapted to the OECD administration will be designed.**
9. Establish an adequate file system. **This has been done, it will be maintained, and the City will continue to work on this task.**
10. Reimburse HUD for all ineligible costs, etc. **The City will continue to provide documentation and urge interpretations of applicable requirements to support all costs incurred. If it is ultimately determined that amounts are owed, they will be repaid to the City's federal program accounts as it already has done in some cases.**

On page 9 of the Report, there is an acknowledgment that during the period of the audit there were three Mayors, the current Mayor only having assumed office November 29, 2000. What is not made as clear is that there have also been several OECD Directors during the period covered by the audit. The current Director was only appointed during 1998. The current Mayor and OECD Director are committed to diligently working to correct the past problems that have been identified and make those changes necessary to ensure efficient and effective operation of these programs. Included in these efforts will be responding and resolving any findings and recommendations made by the City's annual Single Audits and making effective the various new procedures already implemented or in the process of being implemented.

Pages 11 through 13 repeat, in more detail, items responded to earlier in this section. Since additional detail is provided on subsequent pages in the Report (starting with page 14), specific City responses will be provided as required and will be addressed in this response under the relevant Appendices.

Page 14 describes expenditures totaling \$85,987 as unreasonable and/or unnecessary. These costs include indirect costs, rent paid to the redevelopment authority, audit fees, registrations, etc. Continuing on page 15, the Report details the City's actions in providing documentation and support to HUD CPD for these costs, and where necessary, repayment of those funds for which supporting documentation was not available. The Report incorrectly states, however, that the City failed to perform a review required by HUD CPD to identify any other costs that could not be supported. The review was performed and corrective action was taken, as indicated at the Exit Conference. The review was completed in accordance with HUD CPD's directives.

CDBG funds could not be expended in a timely manner (p. 15) since the City's efforts for the period from August 2000 (and some little time before) until the present have been focused on responding to and resolving findings both by HUD CPD and the IG's office. Therefore, the City was relieved of working toward its timeliness goal by the HUD CPD office until all the deficiencies identified in the monitoring review and the audit report are resolved. While it does not intend for this situation to continue, under such circumstances the City may not be able to meet immediately its timeliness goals, but it will try to do so.

Page 17 discusses hiring practices by the City and the availability of file documentation for those individuals hired by the City, specifically the lack of resumes and evaluations for the Director. The resume, evaluation, and hiring procedures used for the Director were available, but were in a separate location from the personnel files, and because of a misunderstanding, the files maintained by the Director of Finance and Personnel were not provided to the auditors. Contrary to statements in the Report (p.18), at the Exit Conference the City stated that information regarding training was provided as requested. Additional copies of the report on training of staff were provided to the auditors subsequently.

In summary, the City recognizes that it needs to address a number of internal management control matters and this will be done. As mentioned earlier, the City administration is fully committed to administering these programs in an effective manner and in securing for its residents the most efficient use of the funds provided from these federal programs.

RESPONSE TO COMMUNITY POLICING ACTIVITIES

The City's response to issues raised in the Draft Audit Report, starting at p. 36, entitled Community Policing Activities, as set forth in Appendix A.

IG Contention:

Documentation was not maintained to reflect either new services or quantifiable increases in levels of existing services and that the services provided were in areas where at least 51 percent of the residents were low and moderate-income persons.

The auditors determined that \$394,735 of the \$415,806 the City spent on Community Policing activities was unsupported and \$21,071 for the purchase of a police vehicle was ineligible. A map provided by the City at the Exit Conference was found sufficient to demonstrate that the residents served by the Community Policing program benefitted low and moderate income persons.

City Response:

In that the Report now states that the issue of demonstrated benefit to low and moderate-income persons was satisfied by the map reflecting the boundaries of the Community Policing program, it is not clear why that issue still remains with respect to the police uniforms and supplies, since these were used by officers serving in those areas or for officers freeing up veteran officers to serve in the COPs areas. These purchases were directly related to the police serving in the Community Policing areas as has been indicated at the Exit Conference and has been attested to by the current Chief of Police who was in charge of the Community Policing program at the time these expenditures occurred.

The reference to Police Hiring in the action plans of the City during 1996-98, that the auditors have suggested was not a complete description of the costs involved, is not inconsistent with the fact that a vehicle, uniforms and supplies for officers who were part of the Community Policing program were paid from CDBG funds. The uniforms and supplies were used by the officers assigned to and working out of police stations in the Community Policing areas. Normally, citizens think of a police officer as having a uniform and being armed with a weapon. One does not normally separate out such items. Making special reference to it in the City's action plan appears to be far too detailed a description than should be required in the circumstances.

As previously pointed out at the Exit Conference, with respect to a vehicle's use, a vehicle log is not the exclusive determinant of whether the vehicle was used in the Community Policing areas. The City has indicated that the current Chief of Police, who was the officer in charge of the Community Policing program during this period, has attested from his personal knowledge that the vehicle was used in those areas. It was used to travel in and to those areas and City Hall, where the vehicle is kept when not in use.

The City has also pointed out that the vehicle mileage was extremely low as another factor reflecting its limited use in the Community Policing areas in contrast to the average 50,000 mile annual average for a typical patrol vehicle that works city-wide. The 1996 Jeep Cherokee van was purchased in July, 1996, was always assigned to the COP unit, and was never used for patrol, excluding in one blizzard, during which it was employed for patrol during that emergency. If it had been used for general patrol it would have had over 250,000 miles on it as of July 31, 2001, but it showed mileage of only 38,863.

An examination of mileage and use log that is now being maintained for the vehicle indicates the vehicle is used in Community Policing areas by officers assigned to those areas, and shows that the average mileage over the last 11 weeks (November 13, 2001 through January 31, 2002) reflects an average usage of 158 miles per week. On November 13, the log read 40,023. This average is very consistent with the 160 miles per week average over the life of the vehicle during its 5 year use by the City Police Force. Thus, there is no reason that with the Police Chief's assertion of use and the consistency of that use with a recent mileage review, that the cost of the vehicle should not be determined to have been used in the low and moderate-income Community Policing areas, and therefore be determined to be an eligible use of CDBG funds.

Similarly, as noted in the Report, the City has reviewed the expenditures and the Chief of Police, again based upon his earlier role as officer in charge of the Community Policing Program, has determined, after a review of the expenditures and the vendors from which the supplies were obtained, that the uniforms and supplies appear to have been obtained for use in the Community Policing program. Specifically they were used for uniforms for the officers who were hired as part of the COPs program and for the veteran officers who were taking over duties in the Community Policing areas once relieved by the newly hired officers. Documents reflecting these matters are being provided under separate cover.

At the Exit Conference, the City pointed out that the issue of whether the hiring of the four additional officers was a new or increased level of funding was an issue that had been determined by the funding agency in this case, the U.S. Department of Justice, since the decision to provide the grant reflects the determination that the funds constituted such an increase in services since that was an express condition of the grant.

Correspondence in the City's files documents the fact that the Department of Justice was expressly asked by the City to make this determination, and that the Department of Justice expressly found that this was an increase in services. (Letter of August 17, 1995, from Charlotte C. Black, Assistant General Counsel, Office of Community Oriented Policing Services (COPS) to Anthony H. Evans, Chief of Police, City of Williamsport).

In addition, a Police Memorandum dated 1-7-96, from Lt. Stephen Scrage to Ms. Connie Turner, Communications Manager, makes specific reference to the expansion of the community policy program, stating:

Also this year our department will be opening three more additional community policing stations with the next several months. The opening of these stations is contingent on the hiring of three new officers and there (sic) return from the police academy.

Copies of this correspondence are being provided under separate cover.

In summary, in making the COPs funding to the City, the U.S. Department of Justice expressly had to determine that the funding for the officers would result in an increase in levels of existing services under the applicable grant requirements, and did so. Further, the amounts spent on the uniforms and supplies, \$16,744, and the cost of the Jeep Cherokee that was clearly reserved for use in the COPs program that operated out of Community Policing stations in low and moderate-income areas all benefitted the residents of those areas.

As a result, and on the basis of this support for the expenditures, the amounts for salary, benefits, and equipment the Report identified as unsupported, \$377,991, have been shown to be supported by documentation that was in the files. The expenditure for uniforms and supplies of \$16,744, is also supported by testimonial and circumstantial evidence. Finally, the \$21,071 for the purchase of the vehicle has been shown to have been an eligible expenditure based upon testimonial and circumstantial supporting evidence.

RESPONSE TO SKATEBOARD PARK

The City's response to issues raised in the Draft Audit Report starting at p. 40 re Skateboard Park, set forth in Appendix B.

IG Contention:

1. Documentation Did Not Demonstrate Compliance with Requirements.

The Draft Audit Report states at p. 40 that the City did not comply with eligibility requirements and national program objectives in using \$20,000 of CDBG funds to support the Skateboard Park developed by the Williamsport Housing Authority (WHA) as part of its improvements of the Kennedy King Low Income Housing Development. The auditors assert that the Park did not involve an "improvement" of that development, and because it is "the only one of its kind within City limits," its use cannot be primarily for the low and moderate income residents in the service area identified by the City that are block groups adjacent to the Park. The City respectfully disagrees.

City Response:

a. The Skateboard Park is a public facility part of the WHA's improvements to the Kennedy King development and an eligible use of CDBG funds. The Park is part of the Kennedy King development. The Williamsport Housing Authority (WHA) obtained the property on which the Park is located specifically to provide a site for recreational activities for the residents of that development and to make productive use of property (formerly owned by the railroad) adjacent to the housing units that was an "attractive nuisance," with the potential to injure children playing on that property before it was improved. The use of CDBG funds to support this objective is clearly eligible under applicable regulations and HUD provided guidance.

The Kennedy King complex is a 100-unit public housing development bounded by a junkyard on the south, a naturally created wet land on the west, and, by a factory on the north. The housing units are crowded onto little over three acres of land, which makes the site use very dense. There was no provision for yards for residents and little common space for recreational activities. One of the goals and objectives of the WHA in making improvements to this property was to create recreational opportunities for the primarily low-income children living in the development. The City decided to use its CDBG funds to assist the WHA in attaining this goal. This is inherently a valid use of CDBG funds under applicable federal statutes and regulations.

Since 1993, the WHA has spent approximately \$1 million on interior and exterior improvements to the Kennedy King development. It made sense, therefore, for the City to assist the WHA in developing the adjoining roughly 13 acre site which was an eyesore and nuisance. By acquiring the land, the WHA was able to provide public housing residents with a unique recreational facility – a skateboard park. In addition, WHA was able to relocate the development's existing basketball court to the site, providing for a much larger space for this activity right next to the skateboard facility as part of this recreational complex for the benefit of the residents of Kennedy King. WHA, consistent with this approach, also moved all of its playground equipment from the three-acre site that contains the housing units to this new recreational area.

The Draft Audit Report seems to suggest that the use of CDBG funds was not eligible because the property was somehow “private,” although owned by a public body, the WHA. To support this contention, the Report states that the City's OECD file contained a letter from the WHA Director stating the Skateboard Park was built on “private” property. The auditors seem to conclude that, therefore, it was not a public facility for which CDBG funds could be expended.

In response to this misclassification of the property by the auditors, the WHA Director provided the City with a letter dated February 1, 2002, that states the use of the word “private” in an earlier communication to the auditors appears to have been taken out of context and is being viewed as a legal term to suggest the use of these funds for this purpose could not be eligible.

The February 1 letter makes clear the site is held in the name of the WHA, the deed to property shows ownership in WHA (to whom the property was sold by the prior owner, the railroad), and WHA is a public body and recognized as such under Pennsylvania law. Thus, the Skateboard Park is owned and run by the WHA, and as such is on property owned by a public body. It is not “private” property within the general contemplation and use of that term.

b. The Skateboard Park serves the primarily low-income residents of Kennedy King and the primarily low and moderate income residents in the block groups adjacent to the site, thus meeting national objective requirements and making use of these CDBG funds eligible under federal law. The auditors further argue that even if the Park is “public,” then use of these funds is ineligible because it does not meet the national objective of benefit primarily to low and moderate-income persons. Similarly, that conclusion is not supported by the facts.

WHA has made it clear that while it developed the recreation area, of which the Park is an integral part, to serve the low-income residents of Kennedy King, the Park is also open to use by others. Making the Park accessible to others who would like to use it, the WHA letter states, is in keeping with its proclaimed social objectives.

Contending this is a unique facility, and the only one in the City, the auditors argue that they have determined the benefit is therefore citywide. Since the majority of Williamsport's residents are not low and moderate-income persons, the auditors argue that means the Park does not primarily benefit low and moderate-income persons. The auditors, however, appear to have concluded that all the youth in the City would come there to use this Park. That the Skateboard Park is part of the Kennedy King development and also that it is not easily accessed by most youth in the City because of various geographic barriers that surround it, suggests this assumption by the auditors is likewise flawed.

Moreover, the auditors' conclusion appears inconsistent with the specific HUD guidance the City used to determine its service area. HUD's "Guide to National Objectives & Eligible Activities for Entitlement Communities" states that the primary responsibility for determining an area to be primarily for the benefit of low-mod persons rests with the grantee. The guidance points out that HUD will generally accept the determination of the grantee unless the *nature or location* of the activity raises serious doubts about the area claimed. Under that standard, the burden is on the auditors to disprove the reasonableness of the City's determination. It is submitted that the auditors have not met that burden.

While WHA does not restrict use of the facility to residents of Kennedy King, this does not mean the use of the Park does not qualify as primarily for the benefit of low and moderate-income persons, both the residents of Kennedy King and those in the adjacent block groups. That the City's determination is appropriate can be demonstrated by analogy to other communities where providing a unique lighted basketball court located adjacent to a public housing development would not dictate that the court could not be considered primarily for the benefit of the low income residents of the development. While those who may use it is not restricted, and it is available to anyone, the nature of its location makes it clear that the activity is such that residents of Kennedy King are the primary beneficiaries, as was intended by WHA.

Following the Exit Conference, the City provided the auditors with the service area for the Park. An earlier version provided during the audit had inadvertently misdesignated the situs of the Park and the service area it served. In response

to this revised service area provided after the Exit Conference, the auditors argue the revised service area documented by the City for the Park is still not acceptable to show that it primarily benefitted low and moderate-income persons and met a national objective for use of CDBG funds.

The Report states that the service area designated by the City in the submission by its Special Counsel was too restrictive. We again respectfully disagree. Based on the guidance provided by HUD, noted above, which the City followed, the service area boundaries we have designated as submitted by our Special Counsel are correct. Under these criteria, the Park clearly primarily benefits low and moderate income persons. Further documentation of usage during the winter when the Park is closed could not be supplied, nor should it be required.

The Report appears to interpret the same HUD guidance differently than the City does. Consistent with the factors considered under the HUD guidance, as the submission made by Special Counsel points out, access to the Park is essentially restricted on three sides: on one side by a railroad line, on another by a thick, forested area, and on the third side by a major thoroughfare, difficult for most children to cross unaided. In fact, the only easy access to the Park is from the housing units that make up Kennedy King. The auditors' contentions are not compelling.

The guidance goes on to describe certain kinds of facilities that can be reasonably assumed to benefit only the residents of the immediately adjacent area and, in particular, cites "small playgrounds." The HUD guidance states: "*In these instances, the area served is usually limited to a few census block groups surrounding the area in which the activity is located.*" In this case, as the service area defined by the City shows, the residents of this area are primarily low and moderate-income persons. The City submits that Skateboard Park clearly fits this description. (24 CFR 570.208(a)(2)(D)) The City was correct in determining that this site met the requirements of 24 CFR 570.201(c). This activity also qualifies as a public improvement for which CDBG funds may be used.

c. The use of CDBG funds for construction of the Park was proper. Finally, the auditors appear to challenge the propriety of the use of the CDBG funds, suggesting that the application of the CDBG funds to specific invoices provided by WHA was not consistent with directions by the City for use of the funds for this project. The CDBG payment was not based on invoices to which it was arbitrarily attributed (funds being fungible), but rather was based upon the work items noted in the agreement between the City and WHA.

The auditors appear to want to disqualify the use of the funds based on language in the City Council's approval of the agreement and work items that could be paid for by these funds. The City files contain documentation that the WHA spent the funds in accordance with the terms of the agreement along with a memorandum documenting a visual inspection of the skateboard facility. That documentation seems reasonable justification for the payment of the \$20,000 by the City towards this project. The Skateboard Park was built, considerably more funds were spent on the facility by the WHA, almost five times the amount of the City contribution, and obviously the necessary work tasks were completed. The additional detail desired by the auditors seems unnecessary in the circumstances.

Clearly the \$20,000 of CDBG funds was an eligible use of these federal funds for the improvements to the Kennedy King development and construction of the Skateboard Park. The City of Williamsport has not determined that the payment of the specified invoices was improper in light of its assistance to this project. These matters are solely within the discretion and purview of the local unit of government. The expenditure was a valid and eligible use of federal funds under federal law.

The Report states that the \$20,000 expended was ineligible because the activity did not qualify for assistance. Since the Skateboard Park is clearly an eligible activity and meets the benefit test for national objective determination on either basis set forth by the City, the basis for the auditors' finding is flawed and it should be cleared.

RESPONSE TO REHABILITATION OF OWNER OCCUPIED SINGLE-FAMILY DWELLINGS

The City's response to issues raised in the Draft Audit Report, starting at p. 43, entitled, Rehabilitation of Owner Occupied Single-Family Dwellings, as set forth in Appendix C.

I.G. Contention:

Rehabilitation costs of \$16,455 that were questioned require verification of correction by CPD. The City's physical inspection of property and its review of records was inadequate, documentation of cost estimates, of grant approvals, and awarding of contracts was insufficient. In some instances, bid competition was not sought, files were missing or disorganized, position descriptions were inaccurate, and productivity of staff was not measured. Waiting lists for applicants for rehabilitation funds were poorly designed and not adequately controlled, and procedures were not maintained for escrow accounts and other items.

City Response:

The City has taken aggressive steps to deal with all of the issues raised by the auditors. Rehab procedures have been revised, code violations have been corrected, and a variety of improvements have been instituted in keeping with the recommendations contained in the Audit Report. Record retention has been improved and waiting list procedures have been revised to properly document all actions regarding applicants for funds under this program. Specific matters set forth in the Report are addressed below.

a. Physical inspections were properly performed and review of records has been carried out consistent with HUD guidelines. Page 11 of the HOME OOSF manual which has been consistently used by the City rehabilitation specialists clearly lays out the process used to verify applicant income. The manual is consistent with HUD's "Technical Guide for Determining Income and Allowances for the HOME Program," which requires PJs to look at a household's future ability to pay. (See attachments C-1, C-2, and C-3, respectively, that are being provided under separate cover) To do this, a "snapshot" of the household's current financial circumstances is used to project future "applicant income." Statements by the auditors concerning income computations do not appear consistent with this Technical Guide which the City has been following.

1. Income calculation was properly performed. On p. 44 of the Report,

auditors reference a homeowner who received a grant for \$6,374. They contend that the homeowner was not eligible because the City's rehabilitation specialist did not properly annualize the actual income of the homeowner. However, proper procedures for determining this homeowner's income and eligibility for a grant were followed by the specialist. The homeowner was not working at the time of her application. Prior to applying for a grant, she had been working for a temporary agency and had earned \$1,600. That employment terminated before she applied for the loan from the City.

The homeowner had been employed until late 1998 when she was laid off from her job of 20 years. In calculating her income to determine eligibility for the OOSF program, the rehabilitation specialist determined that the income was of a sporadic nature and therefore it would not be appropriate to annualize it. The \$1,600 income from the temporary agency was, however, included in the year to date income. The rehabilitation specialist followed the verification of income procedures that are found in Appendix B of the OOSF manual. Based upon that guidance, the homeowner was determined to be eligible for the grant.

2. City policies do not limit grants to code enforcement areas. The auditors contend on p. 45 that a City rehabilitation specialist Ignored the City's own procedures by providing a grant outside a targeted low income area. There appears to have been a misunderstanding of the term "target areas" as applied to housing rehabilitation. The City does not have a target area, as such. What the City has is concentrated code enforcement areas that are subject to more intensive community development activities.

In reviewing the housing rehabilitation grant that occurred outside the concentrated code enforcement area, the family that received rehabilitation assistance in 1998 was an elderly couple. This household had a structural problem with the dwelling's foundation. In light of the urgent structural problem with this home, the City elected to respond to this request for emergency housing assistance. In doing so, the City submits it did nothing inconsistent with its efforts in its code areas, and it certainly made sense to help a low income elderly couple with structural problems in their home. The applicable City procedures will be updated, however, to reflect current City policies.

3. Code violations were corrected without regard to when they occurred. References to asserted failure to correct code violations, noted at p. 45, appear to be based on the auditors "belief" that code violations were not corrected when the work on the particular property occurred. The property apparently was re-inspected by the auditors three years after the grant financed work was completed. This is a considerable time after the work was completed to justify

the assumption that the code violations existed three years earlier.

At the Exit Conference, the OECD Director made it clear that it did not appear that the auditors were correct in their assumptions, because at the time of the completion of the work, when the City inspected the work, the code violations were not observed. Therefore, conclusions about the physical conditions present on two properties visited during the audit several years later were not based upon an inspection sufficiently close to the time that the work was completed to assume that the code violations were not repaired when the work was completed and inspected by the City.

In one property, the auditors said that the rehabilitation specialists did not identify a sagging bedroom floor during inspections of the property. The OECD Director said these deficiencies were not present when the City inspected the unit upon completion of the work. Although they did inspect the property during the audit and after the completion of the work, the auditors' belief that the conditions they found had existed "at the time of the initial inspection," was not merited. The auditors had no basis to make their conclusions other than their surmise; but it was not based upon fact. Actually, when the property inspection was done *more than three years previously* (in March, 1998) *and prior to the inspection performed by the auditors*, the "bedroom" was a storage room full of boxes and clothes. The floor was not visibly sloped or weak. Also, the floor was not sagged. Of course, it is possible that the boxes may have screened the condition of the floor, but it is just as likely that the floor subsequently started to sag because of the weight of the boxes being stored.

Although the City disagreed with the auditors' assumptions, after being informed of their finding about the sagging floor, the City took steps to determine that the owner was eligible for a larger grant. Based upon changes in household income, the owner was determined to be eligible and the City grant has been increased based upon the costs determined and bids were obtained to make the necessary repairs.

On another property, the auditors concluded that rehabilitation specialists did not identify cracked stairs during the initial inspection and that the homeowner removed a wall and a door installed by a contractor as part of the HOME funded work covered by the grant. The City inspected the property more than three years prior to the auditors reinspection. The City has no basis to assume that the stair tread was cracked more than three years previously (April, 1998) when the City inspection was performed. A cracked stair tread, while a deficiency, is a part of the normal wear to be anticipated in an old house. The City believes that the crack occurred after the work was originally completed. Nevertheless, in

response to the information provided by the auditors, the City and the owner agreed to replace the tread and this has been done.

At some time after the City inspected the grant funded work, that owner removed a wall and door in the house. The homeowner said that the door and wall were inconvenient, which is why they were removed. When the auditors reinspected the property, a considerable period after the grant funded work had been completed, they determined that the door and wall were needed to provide privacy to a bathroom and constituted a code violation. Based upon the information provided by the auditors, the City required that the wall be rebuilt and the door reinstalled by the owner. The work has been completed and reinspected by the City. (See documents C4 and C5 provided under separate cover).

The City cannot continually go back to properties once the work is completed and the files are closed. In the event there is a similar situation that comes to the City's attention where work has been removed, the City will review the situation and require the owner to replace the work or reimburse the City for the amount of the work originally performed.

b. Pre-cost estimates are now required. If two bids were received, oftentimes cost estimates were not done. The City now requires pre-cost estimates. This procedure is part of the OOSF CDBG and HOME Rehab manuals. A copy of the relevant portion of the Procurement Procedures is attached (see C-6 provided under separate cover).

c. Bid arrangements were consistent with applicable HUD guidelines. The Report, on p. 45, states that the City's rehabilitation procedures did not require obtaining competitive bids for necessary work and suggests that the procedures under 24 CFR §85.36 require all procurement transactions to be conducted in a manner providing full and open competition.

Homeowners select their own contractors. In the event that homeowners are unable to get through the process on their own, rehabilitation specialists provide assistance to the homeowners. "A HOME Program Model" guidance published by HUD in 2000, states on page 38 that when a homeowner selects the contractor, competitive bidding is not required. The guidance further states that homeowners should be advised that it is a good practice to solicit more than one bid. The PJ must determine cost reasonableness of the selected bid before a construction contract is signed. This HUD guidance appears to be inconsistent with the advice from the auditors. The City is not required to conduct competitive bids since the individual owner selects the contractor in all of the rehab programs.

A similar response is applicable to the statement in the Report that rehabilitation specialists did not properly follow the procedures for opening bids. Since the procedures at 24 CFR 85.36 are not applicable, such bid openings are not applicable.

The City requires that bids solicited by homeowners be sent to the City because the City's experience has been that when contractors send bids to homeowners problems can arise because the homeowners are frequently not sufficiently knowledgeable to properly assess the bids. Furthermore, since there is HUD guidance which requires the PJ to determine cost reasonableness of selected bids, then it is appropriate that these bids be received by the City and reviewed.

d. Grant approvals now go to the Loan Committee. The Report notes, at p. 46, that one project approved by the City's Loan Committee was not documented in the project file for a CDBG-funded grant. The City's HOME procedures required the Loan Committee's review of the grant application for HOME-funded projects, but the CDBG procedures did not. Originally, it was not the intent of the City's manual procedures to take grants alone to the Loan Committee. The manual procedures have now been revised so that all applications for grants and/or loans will go to the Loan Committee.

e. Award of contracts are normally controlled. The Report observes that for one of five projects reviewed, the rehabilitation specialist instructed a contractor to initiate work without knowing if the Mayor and Controller approved the contract. This was not correct. The project was reviewed and approved, in accordance with City procedures; however, the contracts were misplaced and were not in the proper file. The rehabilitation specialist allowed the contractor to proceed since the project was approved, but failed to replace the original documents in the file. This was an error. File controls are being instituted to ensure that this does not happen again. Additionally, contracts have been revised to provide spaces for the signatories and to date the contracts.

f. Progress inspections not satisfactorily documented. The Report states that for four of the five projects reviewed, rehabilitation specialists did not record inspections on standard inspection reports. The files contained evidence that some "unannounced inspections" were made and that homeowners and rehabilitation specialists inspected work before making payments to contractors. As evidenced during the audit, inspections are made prior to the release of payments to contractors. However, inspections may occur while work is being done. The City has notified rehabilitation specialists to document all visits and work observed.

The Report also states that for one residence the City inspection failed to disclose work deficiencies. The auditor observed that pieces of siding had blown off a house and insulation fell down because the contractor did not securely fasten the siding and insulation to the house. The auditor, however, incorrectly assumed that because the siding blew off the house that there were inadequate progress inspections.

The siding was a difficult installation. There was a windstorm which took a few pieces of siding off the building. As soon as this happened, the owner immediately contacted the contractor and relayed what occurred. The contractor said he would repair the work immediately. In the meantime, the auditor visited the property before the repairs could be made. The owner informed the auditor that the contractor was notified. The siding has now been repaired and there have been no additional problems with the siding. Since the homeowner handled the situation and the contractor made the repairs, there was nothing to be done by the rehabilitation specialist.

g. Payments to contractors are to be based on contracts. For one of the five projects reviewed, as noted above, the copy of the contract and the winning contractor's bid were misplaced and not on file; progress payments were made based on invoiced amounts. This should not have occurred. Contracts are to be on file. This should not reoccur since the error and the correct practice has been brought to all the specialists' attention.

h. Organization, Oversight and Supervision

1. Files will be created for all applicants. The Report, on p. 47, states that OECD did not create files for 11 of 61 homeowners who applied for assistance in 1998. Files for an additional five homeowners could not be located. Individuals who apply for the program are contacted in writing inviting their participation in the program. Files are set up for those individuals who respond positively and wish to participate in the rehabilitation programs. Files were not set up for those persons who failed to respond to the inquiry letters.

The City has re-contacted any individuals with missing files. Files have been set up for these persons. The City will make sure that non-participants also have program files.

2. Files are now properly maintained. The Report states that files were not maintained in a professional manner. Significant improvement in maintaining

files has been achieved. Although CPD had noted that the files were disorganized in their August 2000 monitoring report, the Report states there was noted improvement in the files in January 2001. Further improvements have occurred since then. The City has developed a sample rehabilitation file organization format to ensure that the files are maintained in the same way by all of the rehabilitation specialists. As stated during the Exit Conference, major progress has been made in maintaining and organizing files in an orderly fashion. The files also have been reviewed by the Special Counsel's staff.

3. Files now are to provide quarterly status reports on the application. The Report states that although an Assistant OECD Director was responsible for supervision of the rehabilitation program, and one specialist was designated as the lead, the files contained no evidence of supervisory review. Rehabilitation specialists are now required to submit quarterly status reports (see C-7 and C-8 provided under separate cover). In addition, files are reviewed after Loan Committee approval and contracts are signed. Supervisor reviews will be implemented.

i. Position descriptions were inaccurate. The Report states that the position description for one of the OECD Assistant Directors tasked that individual with the responsibility for supervising the rehabilitation program, while it was the responsibility of the other OECD Assistant Director. The City indicated at the Exit Conference that this is a small staff, and that extensive written instructions as to what individuals are required to do are not necessary since individuals are clear as to their responsibilities. Position description also provide for additions to responsibilities without formal amendment of the description. The City will, however, correct the position description to accurately reflect the various employees' duties as part of its updating of position descriptions.

j. Productivity and performance measures are being developed. The Report asserts that the OECD Director could not provide basic management information relating to the productivity of the rehabilitation specialists; that OECD staff did not compile reports to measure productivity; and, that productivity goals were not established or communicated to employees by supervisors.

As explained at the Exit Conference and as has been previously discussed in this Response, the OECD staff is a small one. Formal standards, although common in larger organizations, are inappropriate here. The comments of the auditors are being discussed, however, and to the extent practicable and reasonable, changes will be made.

k. The waiting lists are being revised. The Report states that the waiting list

was poorly designed and did not provide useful information. At the Exit Conference, the City stated that the waiting list (see C-9, provided under separate cover) had been revised to include the date started, name of the rehabilitation specialist assigned, and the date completed.

The Report details certain observations which were described as conditions which reflect a lack of control over the waiting list and the processing of applicants into the program. As previously stated, the new, automated waiting list addresses the concerns raised in the Report.

The Report notes there was a waiting list of 80 applicants and some had been on the list for 15 months. That should not have been surprising. The average rehabilitation costs funded in the City, excluding soft costs, is \$9,000. Additional HUD regulations require the rehabilitation program to remove lead-based paint. The City does not have enough CDBG and HOME funds to address many on the waiting list. The applicants represent one of just many housing and community development needs in the City and unfortunately, few of applicants' needs can be addressed annually. Hopefully, the revised procedures will enable this rehab program to function more efficiently.

I. Rehabilitation procedures are being revised. The Report notes instances where the City's rehabilitation procedures are out of date. The City has already made changes in its procedures to reflect current practices:

- HOME procedures require the use of joint escrow accounts for paying contractors. Procedures now reflect that payments are made directly to contractors.
- HOME and CDBG procedures no longer refer to an employee position that no longer exists.
- CDBG and HOME procedures no longer reference building codes no longer in use.

Summary

The City has implemented a number of changes in its procedures to more accurately reflect the various requirements and practices suggested by the auditors. The City believes that some of the recommendations for detailed instructions and procedures relative to day-to-day management and some of the controls suggested are not necessarily appropriate given the size of the OECD staff. The City, however, will review its procedures and where appropriate will adopt and implement the auditors' suggestions and install additional procedures to improve the administration of this program.

RESPONSE TO BUSINESS LOAN GUARANTEE

The City's response to issues raised in the Draft Audit Report, starting at p. 50, entitled Business Loan Guarantee, as set forth in Appendix D.

IG Contention:

Proper underwriting was not conducted, job creation data was not maintained, loan proceeds were used for other purposes, the City's economic development procedures need revision, and files were disorganized. On this basis, the Report asserts that the loan guarantee was an ineligible use of funds.

City Response:

The Report challenges the use of CDBG funds to meet the City's obligation as guarantor of an \$800,000 loan from Northern Central Bank to Agile Building Technology. Essentially, the Report found the City's use of CDBG funds, while serving a national objective of low and moderate-income benefit, to have been deficient in not having performed proper underwriting for the loan.

In that the use of these funds is consistent with a national objective of job creation based upon a Congressional presumption that the objective has been met in these particular circumstances, as noted in the Report, it is not apparent why the job creation data needed to be maintained in more detail than it was by the City. Documents in City files show that job creation data were kept.

The City acknowledges, however, that in other circumstances, where the job creation data must be shown, more complete records should be kept. In light of its initial experience in this economic development project, the City will ensure that adequate data sustaining the national objective and public benefit will be maintained.

While recognizing that Congress authorized HUD to provide guidance only with respect to the statutory requirement of an "appropriate" finding (the same legislation having dropped the previous "necessary" finding), the auditors have stated that the City did not have sufficient information to make an "appropriate" finding and therefore could not have made such a finding.

It is true that the files do not contain a summary statement addressing the issues in the manner suggested in the HUD guidance material; but it is also true that no specific format for documenting the underwriting for the "appropriate" finding is

required under HUD regulations. In this instance, sufficient documentation is available from the City files to justify a conclusion that a rational decision that the loan guarantee was "appropriate" was made. (The Report, at p. 53, specifically notes that business plans, feasibility studies, and various correspondence were in the file, just not organized in an "orderly" fashion.)

Although both direct grants and direct loans are permitted under the CDBG regulations and statute, either from entitlement funds or through the Section 108 loan guarantee process, the City chose to structure its assistance as a loan guarantee. As designed by the City, the guarantee dropped from an initial \$800,000 for the first 24 months to \$240,000 from the 49th to the 66th payment. That structured approach is itself evidence of a reasoned decision on the "appropriateness" of the financial assistance.

Section 570.209(a) of the HUD regulations provides guidance and identifies certain issues that HUD feels a city should take into consideration when making its underwriting decision. The City had available to its loan review committee a pro forma prepared by Agile, and a review of the pro forma by an independent accounting firm, Parente, Randolph, Orlando, Carey, dated May 1996. There is also a "Sources and Uses" analysis provided by Agile as of 6/13/96.

In addition, there is a feasibility study prepared from the previous year for the initial bank approached by Agile for funding, conducted by Crabtree, Rohrbaugh and Associates, Architects, with input from the Wolff Group of Scranton, Penn., the above accounting firm, Hobbie Personnel of Scranton, and input from the local Chamber of Commerce. Although the eventual lender was Northern Central Bank, this information was available to and was maintained in the City's files.

Funding was also secured from individual investors. Local investors provided \$1,232,000 in equity investment, which is documented, a substantial investment considering that this was a start-up with respect to the particular building technology involved, with the equity totally at risk. The City clearly took note of the interest and confidence expressed, as well as making sure that non-federal funding was secured.

There is additional documentation in the form of minutes from the City Council session and a tape of the extensive discussion of the Agile project by the City's Economic Development Committee. The auditors' finding appears to be based on what they think a documented appropriate decision should look like. Their conclusion that the City did not make an "appropriate" finding based on

information available to it, in light of the documents referred to above, is simply not sustainable.

Finally, while the Report notes on pp. 52-53 that the loan proceeds were “used for other purposes” than to purchase industrial equipment, statements to the City Council indicated that the funds were also going to be used for operating capital. At the same November 21, 1996 City Council meeting cited in the Report on p. 52, the then Mayor stated to the Council in explaining the proposed use of the funds that:

The specific referencing will be clearly delineated in the actual loan agreement. It will specifically state what the proceeds of the loan are going to. There is some prior debt to be satisfied and some legal issues.

As noted in the Report, \$450,000 of the loan funds that were guaranteed went to pay for the equipment. The remainder mostly went to cover past due debts and attorney and bank consultant fees.

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RESPONSE TO HOMEBUYER ASSISTANCE

The City's response to issues raised in the Draft Audit Report, starting at p. 55, entitled Homebuyer Assistance, as set forth in Appendix E.

IG Contention:

City expenditure of \$1,189,523 in HOME funds was not eligible.

The City did not document the necessity for the amount of HOME funds invested in this activity and did not ensure that project costs were reasonable. Davis-Bacon Act wage rates were not applied to workers on this construction and some homebuyers assisted with HOME funds were not qualified. The City is criticized in the Report for not having a subsidy layering review per 24 CFR §92.250 (b). In addition, the Report states that the City had responsibility to evaluate the West End Terrace Project under HUD guidelines found in CPD Notice 98-1, as to whether the developer unreasonably profited from the federal funds provided, i.e., whether more federal funds were provided than was necessary to provide affordable housing.

City Response:

a. The HOME funds provided by the City were used consistent with HUD requirements at the time, and the necessity of the amounts used to reduce costs to the homebuyers with lower than usual incomes has been demonstrated. As noted in the Report at p. 60, the City entered into an agreement with the Developer in 1995. At that time, there was very little guidance from HUD on the HOME Investment Partnerships Program. In fact, the project was developed prior to HUD's issuance of the final regulations cited by the auditors.

1. At the time of the 1995 agreement between the City and the Developer here, final HOME regulations had not been published. They were not published until September 16, 1996. Further technical corrections to the regulations were published on May 28, 1997, and additional amendments on August 22, 1997.

2. HUD Notice 98-1 was not published until January 22, 1998. Again, this was after the initial agreement with the City and the Developer. The language in §92.250(b) simply states the grant recipient (here the City) must evaluate the project to ensure that it does not invest any more HOME funds, in combination with other federal government assistance, than is necessary to provide affordable housing.

3. As a new program, there was little guidance in 1995 as to what documentation the City was required to show in order to determine that it was providing the least amount necessary. In evaluating the City's actions, when published, §92.250(a) states the maximum HOME subsidy could not exceed the HUD 221 (d) (3) standards. In 1999, the 221 (d) (3) limits for a three-bedroom unit in Williamsport were \$105,375.

The amount of maximum funding per lot of \$32,000 was (and is) well below the HUD 221 (d) (3) standards. The City believes providing a HOME funding of 30% of the maximum subsidy per §92.250(a), was a way of determining if the least amount of HOME funds were invested in the project. The auditors' comments do not adequately consider this funding limitation and, had it been considered, the questioned expenditures should have been considered valid.

4. The Report also asserts that the City provided more than the least amount required to fund the first 10 transactions and, in particular, the first of the 10 lots assisted by the City under its investment of \$224,000 in the property. This amounts to \$22,400 per lot. Each of the lots was essentially similar. An appraisal by Beverly Attkisson, IFAS, GAA, Villager Realty, Inc., as of August 23, 1996, has been submitted under separate cover. The appraiser has determined that the appraised value of a lot in this subdivision at that time was \$23,000. Each of the lots in the first 10 transactions was so valued, given the payment by the City for those lots. Thus, contrary to the auditors' assertion at p. 55, the City did not invest more HOME funds than necessary in the project.

At the Exit Conference, the City presented a May 10, 1999, appraisal on lot 45, (by Stryker-buyer). Not only did the appraiser list the lot at a value of \$22,000, but he also gave a value to the improvements of \$68,011 and an additional "as is value" for site improvements of \$8,000. The total value using a cost approach was \$98,011. The appraiser's notes indicate he used a cost of \$54.25 per square foot for construction and relied on cost figures provided by the Marshall Valuation Service and office files.

The appraisal comes to a valuation at \$97,500 for the completed house, including the original land cost. Sale of the property closed on July 30, 1999, and the settlement sheet shows a sales price of \$97,500. The appraisal was consistent with the sales price and indicates a property of this size and type should be sold for the amount of \$97,500. The City believes the current land appraisal and the appraisal of the completed building as part of the buyer's loan application confirm that the HOME funds provided to the Developer on which basis substantial reductions in cost for the house were passed on to the homebuyers were reasonable and fully justified.

There are no assertions by the auditors that the homes were sold for more than their appraised value. In fact, in some of the completed transactions, the sales price of the home realized less than the appraised value. Moreover, the Pennsylvania Housing Finance Agency (PHFA), is a State governmental body. PHFA also provided first mortgage loans for these properties. PHFA has a staff of approximately 125. They did the loan underwriting of each home purchased in this project. They reviewed and accepted the appraised value and sales price of each home. Their vast experience with housing construction across the State of Pennsylvania enables them to determine reasonable costs for construction and sales price of homes. Their knowledgeable determinations fully support the investment of the HOME funds by the City.

5. In addition to the appraisals the City used to determine that the value of the completed homes was within the amount necessary for the buyers for whom these units were intended, the City brought to the auditors' attention that another valid basis for determining whether the investment was no more than necessary was to consider the inherent implication in the reference in the HOME regulations themselves that provide that the sales price of a house acquired with HOME funds cannot exceed the applicable FHA 203 (b) limits. This figure is another indicator of whether the least amount necessary was expended. The obvious implication of use of that figure in the HOME regulations was that sales of housing units below those rates were inherently not excessive.

For example, these limits in 2000 were \$121,296; in 2001 \$132,000; and in 2002, \$144,336. The fact that the 203 (b) limits are not nearly reached for new homes in a new subdivision should be considered indicative of the low price set for these homes, that made them available for buyers with lower incomes than can usually be provided homeownership opportunities. Bringing units in well below these 203 (b) caps reflect that profits to the developer were clearly limited. That the prices for the houses sold in this development were well below the 203 (b) rates serves to demonstrate that the costs are reasonable and the City's use of HOME funds was appropriate.

6. The Report notes on p. 56 that PHFA provided first mortgage loans ranging from \$45,200 to \$73,000 on these units. This information was provided to the auditors at the Exit Conference in a spreadsheet provided by the City showing each homebuyer's mortgage. The Report, however, does not seem to have understood the significance of the facts provided and the significance of the PHFA action.

The range of these first mortgage loans by PHFA reflects that each individual buyer was required to take on the maximum first money loan they could handle. This minimized the amount of HOME funds that would be required to enable the buyer to purchase the dwelling. If PHFA and the Developer had worked out a fixed or predetermined amount of the first mortgage loan for each home, there clearly would be a violation of the HOME regulations in regard to the least amount necessary. But, to the contrary, that is not the approach that the City and the Developer pursued with PHFA.

It was also noted at the Exit Conference that two separate fundings for this project had been provided by the Federal Home Loan Bank (FHLB), \$48,000 and \$380,000. Since the Exit Conference, the City provided the auditors with another FHLB-approved \$190,000 contribution to this project. Total FHLB funds for this project amount to \$670,000. These funds are used as the third position loan for the homeowners to further reduce costs to them and to allow the City and the Developer to make homeownership available to much lower income families than would otherwise be possible. This third loan is interest free and non-amortizing.

The FHLB loan is \$25,000 for persons at or below 50% of median income and \$15,000 for those ranging from 50% to 80% of median income. As a result of this FHLB funding, the City has been able to restructure the HOME loan for several properties. Instead of providing \$32,000 per buyer from HOME funds; the amount of HOME funds was reduced to \$25,000 for several buyers.

At the end of 2001, the City records show 36 homes had been sold or were under agreement of sale in the West End Terrace project. Of these 36 homes, 8 homes will not require the maximum HOME funds of \$32,000. Thus, 7 of the 8 will have or have HOME loans of only \$25,000 and 1 home will have a HOME loan of \$29,300, not \$32,000. The recent additional investment of \$190,000 from FHLB will allow the City's HOME funds to be further reduced when the buyers are at or below 50% of area median income. This is another clear indication that the City has not only attempted but succeeded in providing the least amount of HOME funds necessary to achieve the project, and it is encouraging the Developer to continue to seek FHLB funds.

7. The Developer is required by PHFA and FHLB to do homebuyer counseling. He must provide the counseling with his own funds. Again, this additional expense that must be paid solely by the Developer and further reduces any return from each house sold does not appear to have been recognized by the auditors. This requirement requires that a six-week span covering counseling

for the homebuyer be provided on such matters as managing a budget, caring for the property, etc.

8. The City also noted at the Exit Conference that a section of the HOME regulations, §92. 254 (a) (5) (ii) (A) (5), permits use of HOME funds to reduce the purchase price by excluding the difference between the cost of constructing the house and its market value. This permitted practice is noted on pages 5-13 of the ICF Kaiser Handbook published in June 1999 (and sponsored by HUD) as the development subsidy. The ICF Handbook defines these funds as a subsidy to the developer to make the affordable home feasible.

The City informed the auditors that while this use of funds is permissible, it has not needed to do so here to provide the Developer a "development subsidy." The homes are priced at the appraised-market value. In all of the homes completed to date, there has been no need to reduce the cost of the home to the market value of the property. The City submits that this is a further demonstration that the Developer was not given more HOME funds here than necessary to make the project effective, since the Developer received only what was necessary to bring a home's sales price to the appraised value or less.

The City submits that the various considerations set forth in the above analysis demonstrate effectively that the least amount necessary was provided from HOME funds to this development. The City's analysis is further supported, as noted above, by that of another public body, PHFA, representing the State of Pennsylvania who also determines the necessity of the HOME investment in the project.

b. Contrary to the auditors' concerns, these HOME-assisted units have clearly benefitted these low and moderate income homebuyers. The Report, on p. 57, focused on three homebuyers with incomes ranging from \$16,300 to \$18,200, and then stated "*we have concerns about how these low-income people are able to afford these homes since no upfront evaluation was made. Consequently, we have no assurance these HOME assisted units have benefitted the low- income persons.*"

This statement is rather curious, since the three low-income applicants referred to in the Report are clearly identified as low-income homebuyers. PHFA, a public body of the State of Pennsylvania, does the underwriting and reviews the income eligibility data on all of these purchases and evaluates the financing required. This is due to the fact that PHFA is providing these special mortgage loans only to persons at or below 80% of area median income, the same income criterion used by the HOME program.

It would appear clear that these low-income homebuyers are able to afford these homes based on the underwriting of the loans performed by PHFA. PHFA is providing a much higher amount of public funds per home than the City's HOME program does. PHFA's underwriting criteria include a determination that the buyers can afford the amount of the first mortgage loan. It is the City's understanding that the PHFA underwriting criteria use a total debt load ratio-PITI (principal, interest, taxes and insurance), plus personal debt not to exceed 38 to 40% of monthly gross income. The reason a maximum 40% is used for West End Terrace is due to the fact the houses are so energy efficient. The other criterion used by PHFA is that income allocated to PITI cannot exceed 33 to 36% of the applicant's income. The lower of the two criteria is used by PHFA to make their loan underwriting decisions.

In addition, the auditors' need to understand that these are not only 30 year fixed rate loans, but also that special interest rates are made available due to the PHFA financing. At the Exit Conference, the City pointed out that it has PHFA loans on properties in West End Terrace with a 5.5% interest rate.

The City further submits that the active role of PHFA, an entity of the State of Pennsylvania, another public body in addition to the City which is dedicated to providing affordable housing to low income persons, further supports the benefit being realized by low and moderate income homebuyers. PHFA's role in carefully structuring the first mortgage loans for the West End Terrace homebuyers in amounts that are within the income range of each individual homebuyer ensures that these buyers are fully benefitting from this program.

c. The City accurately determined homebuyer eligibility. On pages 57-58 of the Report, the auditors assert that the City did not accurately determine homebuyer's eligibility. Again, we wish to point out that, in addition to the determinations by the City as to homebuyer eligibility, PHFA, a public body of the State of Pennsylvania in providing affordable housing, also qualifies and verifies that applicants are at or below 80% of area median income. The following responds to the concerns raised about the individual applicants' incomes questioned and their ability to afford their new homes.

1. The Report raised a question about how the City calculated a bonus received by the applicant, saying that the bonus had been erroneously listed at \$500 when it should have been listed at \$600. It would appear that the auditors may have misread the employment verification and did not review the pay stub listing the bonus. To confirm the City's use of \$500, another copy of the pay stub constituting the identified \$500 bonus for the applicant is being provided to the auditors. The City annualized the applicant's income based on almost five

months of current pay stubs. The auditors appear to have based their calculations on an average of the past two years of income, an analysis that is inconsistent with HUD's approach to using a "snapshot" to determine applicant income in these circumstances.

2. In the Report at p. 57, a chart at the top of that page lists buyer #1 as receiving a private mortgage of \$70,261. That is incorrect. The buyer obtained a loan from a private lender in the amount of \$39,500 for 20 years at a 7.75% interest rate. Monthly loan payments, taxes and insurance on this property are \$489.02. The buyer sold another property and netted \$30,761. This amount was included as cash in the purchase of this property. Adding the down payment of \$30,761 to the first mortgage loan gives a total funding of \$70,261.

This applicant had income of \$16,308 per year as calculated by the City. The ratio of the PITI of \$489 per month to total income of \$16,308 is 35.98%. This applicant had personal debt of \$35 per month. Thus, PITI plus personal debt of \$35 per month indicates monthly expenses of \$524 per month. PITI & personal debt payments represented 38.5% of annual income. Both of these ratios are within PHFA accepted standards which are used for all other applicants for the West End Terrace project.

3. In regard to buyer #2 on the chart on page 57, this property closed on October 30, 2000. The Report correctly notes that the PHFA loan was \$45,200. This applicant was paying \$475 per month in rent prior to purchasing a home in West End Terrace. Other monthly obligations were:

\$ 10 for credit card payment with a balance of \$166
\$ 45 for a loan
\$ 88 for a car loan
\$143 total monthly payments

The 30-year PHFA loan of \$45,200 has an interest rate of 6.75%. Loan eligibility for this owner is computed as follows:

\$ 34.25 month for taxes
\$ 16.66 month for insurance
\$293.17 month PHFA mortgage loan
\$344.08 PITI

The buyer purchased the home for \$99,000 with the assistance of \$25,000 in FHLB loan funds and \$32,000 in HOME funds. This female head-of-household

was able to purchase a home and reduce her monthly housing expenses, i.e., her rent had been \$475 a month and now the monthly PITI is at \$344.08.

4. Buyer # 3 on the chart on p. 57 purchased a home in West End Terrace for a sales price of \$92,700. The \$47,500 PHFA loan bears a 6.85% interest rate. Debt payments on this first loan are \$306.66 per month. Taxes and insurance are \$123.08 per month for a PITI of \$429.74 a month. This buyer had an income of \$16,500 per year. She also had a car loan of \$150 per month and a loan balance at the time of purchase of \$2,700. (The loan was originally for \$4,650.) Her PITI costs represented 31.25% of her annual income. Adding her car payments of \$150 per month, her monthly housing and debt costs represented 42.16% of income. PHFA and the City determined she was a good risk even though total debt and housing costs were a bit high. This was due to the fact that she had repaid almost half of the original car loan.

The City followed a HUD technical guide for determining and verifying income. Page 4 of this guide is being provided to the auditors. The City has underlined several statements. For example, at the top of the right side of that page, HUD states that PJ's look at a "snapshot" of the household's current circumstances to project future income. It goes on to state PJ's should assume that today's circumstances will continue for the next 12 months unless there is evidence to the contrary. That is exactly how the City approached the income verification in this instance. The bottom of p. 4 states that HOME rules do not specify precise verification procedures to be followed. A grantee may develop its own verification procedures provided that documentation is sufficient for HUD to monitor. Again, the City's position with regard to verifying income is that it followed this HUD technical guide to determine income. The City contends the amount of HOME funds invested in each property was reasonable and the price of the property was affordable.

d. Contrary to the Report's allegation that the Developer circumvented the Davis-Bacon Act requirements, the Developer, and the City did not enter into any agreements for construction of less than 12 housing units to circumvent the provisions of that Act. The Report, on p.59 asserts that Davis-Bacon Act requirements for payments to construction labor were not followed and claims that the City and the Developer circumvented the Davis- Bacon Act by executing agreements for less than 12 units at a time. The City did not enter into a series of agreements for less than 12 units in order to circumvent the Davis-Bacon Act wage rates.

The Report on p. 8 lists the City's annual HOME grants for an eight-year period, 1994-2000. Over that period, the City received \$2,834,000 in HOME funds, an

average of \$354,250 per year. After 1994, the largest grant was in 1999, in the amount of \$428,000. As required by the HOME regulations, 15% of this grant amount or \$64,200 is required to be used for CHDO activities by non-profit developers. Under §92.507 of the HOME regulations, the City is permitted to charge up to 10% of these funds for planning and administrative costs. Thus, in the highest grant year after 1994, the City had approximately \$321,000 in HOME funds for non-CHDO projects. However, the City consistently budgeted for non-CHDO activities in its Action Plans in amounts that would not have permitted it to use more HOME funds for the West End Terrace project. The City could not finance more than ten units a year. Listed below are other funding allocations from the City's Action Plan:

1996 ACTION PLAN	\$50,000 for owner occupied rehabilitation
1997 ACTION PLAN	\$26,000 for owner occupied rehabilitation
1998 ACTION PLAN	\$47,000 for owner occupied rehabilitation
1999 ACTION PLAN	\$47,000 for owner occupied rehabilitation
2000 ACTION PLAN	\$150,000 for owner occupied rehabilitation & \$100,000 for renter rehab.

As a result of commitments to fund other housing activities with HOME funds, especially the owner occupied rehabilitation program, the City could not fund more than ten units per year. The City had to enter into annual contracts with the Developer since they could not fund the project in any other way. As noted previously, the Federal Home Loan Bank's Affordable Housing Program is a key element to financing these homes. FHLB has a maximum single grant amount of \$500,000. As a result, applications must be submitted annually in a competitive funding. Enclosed is the statement from FHLB on the maximum funds per project approval. The timing and availability of FHLB funds is another reason the funding agreements had to be staged and not for the purpose of avoiding the Davis-Bacon wage rates.

Another factor is the requirement of PHFA at the time of commitment of the homeowner loan. PHFA makes it a condition that City HOME funds be available. Enclosed is a copy of a homebuyer's PHFA approval letter. The letter is from Jersey Shore State Bank, the loan originator for PHFA. Item 13 on page three of the letter requires evidence of the availability of HUD grant funds **before** scheduling a closing.

With limited HOME funds, it would not be feasible for the developer to build homes in a larger number than ten with the limitation of the City's HOME funds. That is another reason that the HOME project had to be drawn down in stages. With the City's limited annual funding average of \$354,250 per year, it was not

possible for the City to undertake a large-scale project, and the developer could not build and carry the homes until the HOME funds were available for closing.

As mentioned previously, the developer is obligated by PHFA and FHLB to undertake a homebuyer-counseling program. It takes time to screen eligible buyers and to provide the homebuyer counseling. Secondly, there is the market absorption factor. In a City of 30,706 there are a limited number of low-income persons seeking housing. Most of the buyers have determined they could not afford to buy without the assistance provided. An absorption rate of ten or less units is reflective of the market in Williamsport.

The Report on p. 59, notes that the City executed two separate agreements with the Developer on the same date, for six and eight lots. The City recognizes that the two agreements were approved by City Council on the same date. The approval occurred on July 8, 1999. That is not dispositive, however.

The City Council was late in approving the funding of Fiscal Year 1998 funds and this did not happen until July 8, 1999. By that time, HUD had approved the City's 1999 Annual Action Plan. The City determined it would be more efficient to have both funding agreements approved at the same time. In essence, the City was late on the 1998 approval and on time with the 1999 approvals, and was seeking to catch up on the funding that needed to be available for this project. In that the agreements cover two funding years, while approved on the same date, each agreement stood on its own, and the first of the two related to the prior year's commitment of funds for this project.

RESPONSE TO BLIGHT ELIMINATION

The City's response to issues raised in the Draft Audit Report, starting at p. 61, entitled Blight Elimination, as set forth in Appendix F.

I.G. Contention:

Activity did not meet national program objectives and was not eligible for funding.

The Draft Audit Report states at pp. 62-64 that use of \$350,000 in CDBG funds by the City to acquire and demolish an abandoned blighted factory complex was deemed ineligible. While the expenditure initially met the national objective of slum and blight clearance, the reuse of the property for a 58-unit elderly housing development does not appear to have benefitted low and moderate income persons even though the funds used to acquire and demolish the property are to be repaid to the City over time.

City Response:

a. The amounts provided by the City for this project met applicable national objectives and thus were an eligible use of CDBG funds. In 1998, a for-profit developer approached the City with an unsolicited proposal to eliminate an abandoned, blighted factory complex. This particular property had been a major cause of concern to the City because of its blighting influence. As the Report states, the City's files contained photographs and copies of code violations demonstrating the blighted condition of the building.

It is not an uncommon practice in many cities for potential developers to approach city governments with proposals for redevelopment of blighted properties. Oftentimes, these properties are included in formal and informal plans of the city for physical development. Sometimes the magnitude of the physical development is such that cities are leery of formally incorporating these types of properties into plans and funding streams. Additionally, cities face major acquisition problems when word leaks out that the city is interested in developing particular parcels. Many times when this happens, acquisition prices increase dramatically, making it infeasible for the city to pursue acquisition in the traditional sense.

Thus, cities are often responsive to developers who are able to secure some financing for a project and approach the city with a clear, viable vision for demolition of the blight and subsequent physical redevelopment. This has

typically been described as a private/public partnership, primarily because the developer is carrying out the ultimate redevelopment plan for a particular property for the city.

In this instance, the developer acquired the property on behalf of the City in order to fulfill the City's objectives of spot blight removal and to create a mixed income project. In return, the City agreed as part of its plan to achieve that objective to allow the developer to repay over time the City funds used for acquisition and demolition. The transaction was dependent upon the developer securing construction financing through private sources for the elderly housing project. The developer acquired the site, demolished the blighted factory, and secured the necessary private financing to build a 58-unit elderly housing development.

b. The elderly housing project primarily serves low and moderate income tenants residing in it. Although the project has continually been described as a market-rate rental project, this was done, as is typical, for marketing purposes in order to attract tenants with higher levels of income, to achieve a mixed income project, and to avoid stigmatizing the project as low income. It was clear, moreover, prior to the completion of the project and during the lease-up phase, that there was no clear market for just higher income elderly persons. In fact, most elderly are unlikely to have the higher incomes that could make this a market rate project. Rather, the goal was and continues to be to achieve a mixed-income development. That is what now exists.

There is a fallacy in concluding that because a housing project does not meet established fair market rents (FMRs) for a particular area that individuals who are at 80% of median income or below are priced out of the market or that the units are not affordable for those with incomes in that range. That certainly has not been the case for this particular project.

The kind of activity described here occurs in many cities. Developers are used to acquire property to keep the cost down for the cities. Because developers acquire property does not mean that they are free to do with it as they wish. In this instance, as is usually the case, the City funds were provided based on achieving the City's initial objective of spot blight removal and the developer's objective for redevelopment of elderly housing that would benefit low and moderate income persons. The developer was required to comply with specific criteria for clearance of the blighting influence on the property in acting for the City in this regard.

The developer acted on behalf of the City at the time the property was acquired and achieved the initial goal of the City to remove a blighting influence. This was not just an acquisition of land by a private developer. The City made a reasonable financial decision to allow the developer to purchase the property on its behalf in order to keep acquisition costs down and to allow for a more expeditious process in removing the blight, and, ultimately in gaining reuse of the parcel.

The developer agreed to repay to the City the funds provided for the acquisition and demolition over 30 years with a simple interest rate of 2 percent. Principal and interest payments were deferred to years 20-30. The initial 20-year term for the loan was established because the City recognized that a substantial number of low to moderate people were likely to be living in the units, thereby helping reduce the costs that would have to be realized from tenant rents. Further, the City would be repaid the funds it expended to acquire the land so it could have the blighting influence demolished.

During the Exit Conference, the City indicated it had evidence that the elderly housing project, in fact, met a national objective because more than 51% of the people living there were at or below 80% of median income for the area. Subsequent to the Exit Conference, surveys of the tenants were completed. Of the 50 occupied units, household income information has been secured for 37 units. Of the 37 occupied units, 30 units (more than 51 percent of the 58 units in the project) are occupied by tenants who have incomes at 80% or less of median income. The project, therefore, meets a national objective of benefitting low and moderate income persons.

c. Since CDBG funds were only used for acquisition and demolition which was reported, and not for construction funding, the City met applicable reporting requirements. The Report states that the City did not inform HUD and its citizens about the reuse of the property. The City determined that since it reported on the use of the City's funding for acquisition and demolition that it had adequately met HUD's reporting requirements. It was not required to provide further information since no City funding was provided for the construction of the elderly housing.

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